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INTERNATIONAL ECONOMIC CO-OPERATION

by

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PREFACE

This book is intended to rouse interest in the problems of international economic cooperation in the circles of those who come into contact either with economic or with international problems. It aims at elucidating some points of misunderstanding which, I have found, are frequently met with in this field of study.

Besides explanations of an economic and statistical nature it also contains some pleas of an economic-political nature. In addition to recommendations given elsewhere for a modern trade cycle policy, the renewed significance of an 'organized' free trade is pointed out, as well as the desirability of granting considerable capitals to countries with a low standard of living — and therefore the desirability of a continued formation of capital —, the necessity of a reasonable settlement of the problem of war-debts and reparation-payments, and the necessity of a correct choice in the matter of parities of exchange as well as some difficulties not generally recognized in this connection. Above all this study has ultimately become a support of the idea of an international centre of economic policy, vested with more power than the Economic and Financial Organization of the League of Nations before 1939.

SUMMARY

THE ESSENCE OF INTERNATIONAL ECONOMIC RELATIONS

CHAPTER I. *Introduction; the heterogenity of world economy.*

The aim of this book is to increase the insight into and the interest in international economic relations with a public that is interested in economics. After an explanation of the essence of international economic relations there follows a discussion of the question whether a 'regulation' of these relations is desirable, and of some suggestions which have been made in this connection.

The world's economic system consists of a great number of national economic systems, which in some respects are independent of each other, in other respects interdependent. The latter show great differences in population and in wealth. The wealth may be in natural resources and in capital goods; figures. In each of these national economic systems there is production: goods are produced with the aid of the three so-called factors of production: nature or land, labour and capital. The quantity of product per head is greatly dependent on the amount of land and capital per head of the population. Hence great differences in prosperity; figures. China and India the principal 'development areas' of the world. The total product is divided among the factors labour, land and capital in proportions which, curiously enough, do not greatly vary for different countries; broadly speaking they are 70, 10 and 20 %.

In accordance with what has been observed, the following possibilities of economic intercourse between nations present themselves:

1. Exchange of products against products: current commercial intercourse;
2. Transfer of production factors:
   a. of persons: migration;
   b. of land: change of territory;
   c. of capital: i.e. import and export of capital.

In the economic sphere, 2b is practically without importance; it does play a part in the political sphere, as a result of war. Then 2a and 2b may occur at the same time. In the economic sphere 2c takes the form of import and export of capital. The importance of 2a in the economic sphere has become very slight these last 20 years.

Chapter II. *Current commercial transactions.*

The exchange of goods and services between two nations has sense, because relatively speaking one nation can make one product more easily, another nation the other product: consequences of differences in natural resources, natural ability, technical accomplishments; examples. World-commodities are those goods which are easily transportable in proportion to their value. Every commodity has a certain distance beyond which it can hardly compete. Also for this reason big countries have, relatively speaking, less commercial traffic. There is imperfect international competition.

In case of a *free exchange of goods* every producer would make the article with which he would obtain the highest remuneration for this trouble. This does not mean to say that all articles are produced there, where the trouble would be smallest. For in that case some nations would have to produce nearly everything, others nothing at all. They are produced there, where the difficulty of producing them is relatively smallest: as compared with the trouble to be bestowed on other products: theory of comparative cost. Countries which along the whole line have a small (great) difficulty of production, enjoy a high (low) standard of living: wages, expressed in goods, are high (low) there. It is a misunderstanding to think that countries with high wages should be unable to compete with countries with low wages; it is not so much real wages per hour that count, it is the wages in money per unit of product. Perfect commercial equilibrium is possible with great differences in wages.

However, a free international exchange also exposes a country to *disturbances*: the rise of new competitors. This has given birth to the conception of limiting free exchange by import duties, quota systems or prohibitions.

Hence, current commercial intercourse can take place according to three methods: it can be *left free*, it can be *hampered* arbitrarily by protective measures, or it can be *controlled*. On closer inspection this last method can be subdivided into 1. control where the guiding principle is that which would take place in the case of free trade, only preventing excrescences (too great variations, dumping) and 2. control where there is free trade within specified areas and these areas are shut off from the outer world by systematic tariff-walls. From an economic point of view there is fundamentally only the contrast between free and limited commercial intercourse.

If the taking up of all productive units (*full employment*) is a certainty from the outset, *unhampered exchange* yields the highest

total production: each unit produces that for which, relatively speaking, it is best suited. Every deviation from this means, for every country, a smaller prosperity; it can only be an advantage for some groups within certain countries, at the expense of other groups in the same country, because the total value of production of the country is smaller. If full employment is not certain beforehand, then, within the borders of one country, protection can contribute towards an increase of employment and therefore raise prosperity. It may, for a specified area, mean the breaking of the vicious circle of a depression. It may also mean the *gradual* completion of a change of structure that has become necessary: adapting oneself to another production — now the relatively most profitable —, in consequence of new foreign competition. The danger of protection, however, is the *continuation* of less productive work and hence the 'growing crooked' of the development. Last of all, as a temporary measure, protection can raise the suitability of certain productive units ('education') and therefore contribute towards an ultimate increase of prosperity also of other countries.

Even in the absence of artificial hindrances, competition in the world market is not so perfect as theorists sometimes believe. There is imperfect competition; the elasticity of the share of any one country in world trade with regard to the price-relation between that country and world trade is about 2. Actual data concerning international trade and its development.

CHAPTER III. *Transfer of factors: territory, population and capital.*

Transfer of *territory* is far less a matter of peaceful exchange than transfer of the other factors: for, when such an area is also inhabited, it also means a transfer of that population to another nation, with a different civilization or language or both. It nearly always means war. In proportion as the quantities of free territory decrease, it becomes more difficult accordingly to supply the needs of it; this holds good especially for countries with limited territory (Netherlands, Japan).

Transfer of *population*, on the other hand, does occur in a peaceful form, i.e. in the form of migration. The population of the United States has entirely arisen from migration. After 1918, however, emigration has no longer played any part of importance; the international movement of population has largely come to a standstill, also because there is hardly any territory left that is politically free. Although the importance of emigration for over-populated areas should not be over-es-

timated, it presents a serious problem, which cannot be settled by declaring the status quo as sacred or maintaining it for military considerations only.

Viewed economically, by far the most important form of peaceful transfer of production factors is that of *capital*. It takes the form of loans or participation, and can be given for long or short periods. The granting of long-term credit, in its real aspect, i.e. apart from the financial form under which it appears, comes down to this, that means of production or commercial stocks are placed at the disposal of a little developed area by one of the highly developed countries, and that the former, by way of interest and redemption, annually gives up part of its production. In this way the means of production concerned generally become more remunerative than they could have been at home. Moreover, this transaction raises the prosperity of the little developed areas, by which a certain *levelling* is brought about. For that matter, the net amount of levelling has not been very great so far: the proportion of prosperity between the rich and the poor countries has changed very little indeed these last fifty years. For great hindrances to capital-export are to be found in the uncertain political conditions in the less developed areas (China), in the small technical capacities of many of these nations, and in the numerous difficulties of exchange and other financial matters (South America).

Granting capital on *short* term has a much smaller direct significance for the great lines of actual development, but is of eminent importance for the stability of finance, and is consequently of indirect importance. (See chapter IV).

CHAPTER IV. *The technique of financial transactions.*

Only gold is legal tender everywhere; payment in gold involving great cost, the fact has to be faced that every country has other, its own, means of payment. Payment to foreign countries therefore requires a '*transfer*' of home into foreign means of payment ('foreign exchange', often 'bills of exchange'). This is effected by means of an exchange at a certain price (rate of exchange). All payments made in a certain period between a country and foreign countries, are together called the balance of payments. This is subdivided into current items (balance of trade, or imports and exports of goods; invisible imports and exports, or payments for services in shipping, capital and otherwise) and capital items (import and export of capital for long and short periods, and the balancing item of gold shipments). It is also

possible for the balance of payments to show reparation payments. Sometimes the 'balance of payments' is understood to comprise all these items without gold; in the former case there is always equilibrium, in the latter not necessarily so. But even then there must be equilibrium in the long run; otherwise there would be a permanent accumulation of gold. In comparatively small quantities, however, this is possible for long periods consecutively: the U.S.A. 1929-1939. Such an equilibrium in the long run must also exist, however, and for analogous reasons, for no matter what part of a country, whether it has money of its own or not. The difference is that in the former case, by altering the rate of exchange, equilibrium can be attained even at short notice. Stability of the rates of exchange is an advantage for the certainty of calculations of trade and investment. Sometimes, however, the rates of exchange can, by the side of more or less fixed prices at home, also be used to regulate home activity. Accordingly there are two systems: I. that of fixed rates of exchange a. with gold cover or b. with other cover, and II. floating currency. I. is usually preferred.

With the *gold* standard there is, at the Central Bank, a fixed relation between money and gold; the rate of exchange corresponding with it is called parity. The gold points indicate the limits, within which gold shipments in one direction are unremunerative. Only in case of a rigorous equilibrium in the balance of payments does the rate of exchange remain within them. If either of the gold points is reached, a movement of gold will follow. This will then see to the balancing and accordingly to a maintenance of the rate of exchange at the gold point in question. If it should last long, an exhaustion of the gold stock on one of the sides will be imminent. This can be prevented by a. indirect and b. direct action. Indirect action can be 1. automatic, resulting from the altered quantities of means of payment: a decrease of the gold stock leads to a diminution of the circulation of money, this leads to a reduction of incomes and consequently to reduced imports and lower prices, by which exports will even increase again. This automatism, however, works faultily and very slowly. Indirect action can also be 2. deliberate interference, namely a raising of the rate of discount in the country where the gold stock threatens to become exhausted, owing to which partly the same results are attained (though also very slowly), but especially short-term credits flow in from abroad (provided there are no other counteracting factors, such as lack of confidence). This process, however, can only be for a time; then an exhaustion also of these credits will arise. A good instance of this form of

action is provided by the defence of the Dutch guilder in 1935/36.

The direct action referred to above consists in the stoppage of the issue of gold; then, however, the gold standard is abandoned; or in a regulation of international financial transactions.

For the rest, the danger of exhausting the gold stock is smallest, of course, when a country has a large gold reserve at its disposal.

Besides gold, a country can also base its currency on 1. other monetary units (gold exchange standard) or 2. by the side of gold on other goods (raw materials, silver). Also in that case the importance of an ample reserve is evident (equalization fund). The difference with the gold standard is often exaggerated.

In principle, even the *floating* standard does not differ very much from it. The limits between which the rate of exchange is allowed to fluctuate can be chosen more or less narrow or wide. In case of a floating exchange, the rate also helps in arranging the equilibrium: it will be endeavoured to avoid the small fluctuations in the balance of payments by operations of the equalization fund; but the level of the rate of exchange can be altered gradually in order to affect imports and exports. With slight movements the speculative influences can be avoided which occur in the case of rapid movements, and which sometimes promote a state of equilibrium, sometimes quite violate it (Germany 1923).

CHAPTER V. *Equilibrium in the balance of payments.*

We will now, on a somewhat broader basis, consider the problem of how to maintain this equilibrium in the long run.

If all economic magnitudes should immediately and completely *adapt* themselves to altered data (in this case the rates of exchange), the rate of exchange would be *indifferent* to the actual course of events, i.e. to the height of production and employment as well as to the equilibrium in the balance of payments: if it were halved, all prices would immediately become twice as high, and nothing would have changed in remunerativeness, real wages, etc. Nor would anything be changed, under this condition, if the parities of all countries were to undergo a proportionate shifting and the regulations for cover should be altered in the opposite direction: e.g. if all parities were to be raised by 25 % and all cover reduced by 20 %. The same thing would hold good if only very gradual changes were to be brought about in the data. In other words, very slow changes in the rates of exchange are of no consequence for the equilibrium in the balance of payments; hence they can simply be fixed without any harm to that equilibrium; this is

even desirable in order to give a greater degree of certainty to all calculations.

In reality, however, there are also *immobile* or little mobile economic magnitudes: they react only after a certain delay and often also insufficiently to restore the static equilibrium. Instances are prices, wages, interest and other payments which do not vary directly with the economic situation. Then it is possible that the rate of exchange affects both the size of production and the equilibrium in the balance of payments. If the rate of exchange is also immobile, no equilibrium is possible. Either the rate of exchange or prices should be mobile. For both to be mobile is less desirable again: it may cause too much uncertainty, as we already saw. If prices are completely immobile, the *parities of buying power* are under certain circumstances the correct rates of exchange. Regulating production by means of rates of exchange and, for example, of wages are not identical in their consequences. In case of an adaptation of wages the worker bears the whole burden, to the advantage of the unemployed and the non-workers. In case of an adaptation of the rate of exchange the worker and the non-worker bear the burden together. Moreover, the speculative results are quite different: adaptation of the rate of exchange causes a rise of prices at home as well as animation to buy; adaptation of wages causes a fall and a waiting attitude.

Also in the case of slighter mobility it is possible, however, that the rate of exchange is *not a good regulator* of the equilibrium of the balance of payments. It is quite possible, for example, that in the event of a fall in the rate of exchange imports and exports rise to the same extent. Exports will rise in any case; imports would even fall if the incomes should remain the same. They rise, however, and it depends upon a number of elasticity-coefficients what will happen. Graphical illustration. In that case both the rate of exchange and wages are generally bad regulators, while also the influence of imported economic fluctuations does not affect the equilibrium of the balance of payments. For employment, however, they are good regulators, though taking some more time. If the country concerned has to pay interest or reparations, these will have a much greater effect on the equilibrium of the balance of payments. Should these payments themselves be the cause of a disturbance of that equilibrium, a very great adaptation of the rate of exchange would be required or no adaptation of the rate of exchange whatever would be of any avail.

The connection between internal *monetary equilibrium* and

equilibrium in the balance of payments. If for some time at a stretch a country spends more than its income — in consequence of dishoarding or the creation of money —, it will as a rule also import more than it exports, and equilibrium is only possible when the dishoarding or the creation of money is stopped. The rate of exchange may be of use in this case when it affects the latter, but not when it has no influence on it. It can have this influence because it affects the level of activity and consequently the income.

Through these considerations one gets to know at the same time the conditions which, in the case of impotence of the rate of exchange, are of importance for the equilibrium in the balance of payments. All the factors which determine the hoarding or dishoarding are also of importance in this connection, such as for example the organization of the state finances and the monetary system (Germany 1923) or the presence of reparation payments; also factors of political uncertainty or reluctance against government measures (U.S.A. 1933-38).

So far we spoke of slow movements, or movements occurring once, in rates of exchange and wages. In practice it is attainable that a rate of exchange, after adaptation, remains fairly stable, though floating (*equalization fund*). If the rate of exchange is not thus kept in hand, further consequences, '*speculative*' ones, will occur, which may result in a further disturbance of the equilibrium (Germany 1923), but also in its being found more quickly (Norway and Denmark 1926). Speculation of a twofold kind: based on the position of the rates of exchange (sound) and based on the movement (unhealthy).

Summary: in case of a partial rigidity of economic life the rate of exchange can have an influence on the equilibrium of the balance of payments; it is also possible, however, that it has no sufficient influence. An investigation of the facts is needed in any case that occurs. The factors affecting monetary equilibrium at home will be of importance in any case.

REGULATION OF INTERNATIONAL ECONOMIC RELATIONS

Chapter VI. *Aims of a regulation.*

The chaotic situation of after 1918 and especially after 1930 cannot be put up with again. If patchwork is to be avoided, then there ought to be a programme and consequently a purpose. This purpose should be the '*general interest*'; but in trying to

define this further, we meet with great difficulties. The principal are:

1. The idea of general interest is vague, as long as no method has been found to weigh a decline in the satisfaction of one person against an advance in that of another.

2. The satisfaction of anybody's wants is dependent on widely diverging aspects of human life: material goods, health, liberty, employment, a certain measure of certainty. The furtherance of one aspect often brings about opposition from another.

3. People often do not know their own happiness: their ideas about it are frequently incorrect or too limited.

4. People often differ in natural ability, accomplishments and desires: tastes and needs differ.

Viewed internationally this becomes even more difficult in consequence of the great differences in the views of life, the capacities, wealth and history of the nations, which, for instance, find expression in aspirations and regime (Germany, Russia, Japan) and in consequence of the sovereignty of nations accepted hitherto.

The complete solution of this problem of the organization of the international community is not the task of the economist. Like the politician he has only a modest place to occupy by the side of the expert in matters of government and other organizers, the psychologist and the pedagogue, the sociologist and many technical experts. It is to be hoped that at the Peace Conference this will also be realized with respect to the politicians.

Only the *economic aspect* will come up for consideration here. We think we may formulate the aims as follows:

(a) a production as large as possible;
(b) a production as stable as possible;
(c) a distribution as just as possible among
 1. persons and classes, and 2. nations;
(d) as few conflicts as possible, both at home and abroad, and
(e) as much freedom as possible for the parts.

Even then the question remains, how these aims, so far as they are contrasting, have to be weighed one against the other. As long as measurements are not possible, this must be left in many respects to the subjective views of the economic politician. The points (d) and (e) then have a more passive meaning; especially in the case of (e) it should be ascertained first, in how far the other aims leave the possibility to comply with it. Partly the attainment of one object will further that of the other; thus the number

of conflicts will be diminished already, when the demands (a), (b) and (c) have been met to a greater extent than before.

Most of these aims have an internal aspect for every country as well as an international aspect; in this book only the latter will be dealt with. This means that for some points, especially (a), even the main points will not find treatment here.

The principal measures through which these aims can be attained are, as far as points (a) and (b) are concerned, a *good trade cycle policy* in the widest sense of the term; such an economic policy is possible when on the part of industry there is sufficient understanding for the rôle which the authorities will have to play, in a supplementary way. In Great Britain there is a strong tendency in that direction; with regard to the United States there is reason for doubt (Myrdal's latest book). Point (c), as far as the distribution within one and the same country is concerned, is mainly a question of *taxation* and *social legislature*. All these measures largely take place within the separate countries, and it is especially of importance here what the big countries will do. International relations only play a minor part. Nevertheless they should meet certain requirements. The aims mentioned under (c2), (d) and (e) are, according to their nature, to a greater extent questions of international relations. A diminution of the differences in the standards of living should be effected in the first place by *export of capital* from wealthy to poor countries; a reduction of the number of international conflicts, in so far as they are economic matters, will have to be attained by banning arbitrary procedures in commercial policy and technique of payment, apart yet from the field mentioned just now.

The demands which points (a) and (b) — mainly concerning the internal employment policy of the big countries — make upon international relations, find their origin in the disturbing influences emanating from international financial and commercial intercourse, both as to absolute height and stability. Besides endangering the stability of production of the big countries, they far more imperilled that of the smaller ones. Therefore points (a) and (b) are chiefly international questions for these small countries. For one part the disturbing influences mentioned found their origin in the *sovereign power of nations* in the field of commercial policy and technique of payment. Hence a curtailment of this sovereign power in behalf of international settlements is absolutely necessary; the commercial and financial systems will have to comply with certain standards. It must be impossible suddenly to close frontiers entirely or partially for products from other countries; further the monetary

management must be up to certain requirements as to stability: great fluctuations in the rates of exchange or even the threat thereof, by unsatisfactory management, must in future be impossible. In this connection it will be unavoidable to find a correct settlement of the problems of war debts and reparation payments.

For another part those disturbing influences, starting abroad, found their origin in *depressions*, with the accompanying tendency to hoard, in other countries. By international cooperation it should also be attained that all countries — in so far as they are of sufficient importance — undertake the obligation to carry on a correct economic policy.

Last of all, a certain regulation and guarantee of capital exports will also be able to contribute towards a greater stability of production.

CHAPTER VII. *Problems of territory and population.*

If one tries for a moment to disengage oneself from the military and political situation of the present moment and only puts the economic problem — in broad outline and for a more remote future — of how to supply to the world's population a prosperity as high as possible and spread over the nations more equally, one encounters two primary facts: 1. this prosperity could increase more quickly, if the *population* in a number of countries *increased less rapidly* (illustrated, for instance, with figures about Chinese agriculture); 2. it would be spread more evenly, if the *property in natural resources were distributed more evenly*. Particularly the Anglosaxons have a very large share at their disposal. Both problems are international in character: it cannot be a matter of indifference to the outer world, if Japan, Italy and later perhaps China and India, in consequence of surplus populations, come with certain demands. Therefore the problem of how to regulate population presents itself nationally as well as internationally, and sooner or later we shall have to come to an international policy in this connection. As a matter of fact the demand put to Japan to withdraw within her borders of 1897 will come down to a demand of population policy in the name of the United Nations. Unfortunately the discussions about these questions are rather charged with dogmatic notions connected with the moral aspect of birth control; those who object to this should realize, however, what the demand put to Japan involves, and also what consequences their standpoint will bring along for the world at large.

Also the question of the more even distribution of natural resources is a problem: free possibility of purchasing raw materials is not a complete solution. The production of raw materials itself is a source of income, to which every nation has a certain right.

The solution of these questions is inopportune at the moment. They do not come up for treatment until the political organization has become more stabilized. But they should be observed already.

Chapter VIII. *Prospects and regulation of international trade.*

Although in the first few years after the war there will be an urgent demand for goods for *reconstruction purposes*, great anxiety is felt for the period after that with reference to the new *race for export markets*, while in various countries plans are being made already for a curtailment of imports (Great Britain). This threatens to become a repetition of after 1930. It is a typical result of a '*slump-mentality*', in which every competitor is dreaded for his supply, but it is forgotten that, if he sells more, he can also buy more. It is the reverse of what was to be seen and will be seen in the periods of war and reconstruction. It is the other side of the tendency, present indeed in a time of depression, but on no account necessary for any period, not to spend part of one's income.

Closer investigation of the *Japanese competition* which occurred in the past — and moreover in a time of depression and therefore causing particular anxiety — shows nevertheless that even then it was overlooked by many commentators that Japan at that time also bought much more than before. It is indeed true that Indonesia did not immediately and sufficiently benefit by it; but it may profit by it indirectly; it is also possible that in future more raw materials can be supplied to Japan. For the rest, Japanese competition was partly a competition of inflation, which it cannot keep up.

Another mentality than the slump mentality is necessary, if ruin is to be avoided; if free trade and industry, aided by *supplementary state expenditure*, cannot bring this about, it will have to be replaced by *socialisation*. Because of the loss in initiative and freedom which this signifies it is to be hoped that free trade and industry will have sufficient energy to tackle enough new projects, be it with somewhat slighter chances of profit, but more certainty instead of it, and also that sufficient appreciation will be shown for governmental initiatives for an extension of production.

If one allows oneself to be guided by the views developed in the preceding pages that:

1st, *full employment* is necessary and possible within reasonable limits, owing to which a slump mentality is unnecessary;

2nd, *commercial equilibrium* is possible between nations with a *high* and those with a *low standard of living*;

3rd, there are *limits* to the capacity to pay interest and redemption on *war debts* and *reparation payments*,

then a proper arrangement of international commercial relations is also possible and prospects are not even unfavourable. The latter statement is illustrated by the calculations of *Colin Clark*, who shows what extent trade might attain in 1960, if the tendencies of growth in production and population which we have observed since 1900 should continue and full employment as well as free trade be realized. It appears that the world's commercial intercourse is capable of considerable development, provided there is equilibrium between rich and poor countries, and that, moreover, the price level of agricultural products gets almost twice as high as compared with that of industrial products.

From the preceding arguments, especially those of chapter 2, it appears that the best kind of planning is that in which *free trade is taken as a model*. This does not imply that individual traders should be entirely free; on the contrary, organization in order to prevent abuses, double work and too great variability and also to absorb shocks, is to be recommended. But no systematic closing of markets by tariff walls or quota systems must take place. International consultations about the application of new products will, of course, benefit stability; but foreign competition should not be permanently locked out.

Particularly the *fear of the competition of countries with a low standard of living* is unfounded, resulting as it does from group-egotism and the slump mentality already mentioned. In order to view this problem in its right proportions, it is necessary to remind oneself that:

1. the poor countries form an investment market for the surplus formation of capital in the wealthy countries;
2. they become better purchasers of the products of the wealthy countries, and
3. they, moreover, contribute towards the prosperity of the latter by reducing the cost of living.

A defence against low-wage competition should only be based on economically correct means; these consist of:

(a) raising one's own economic achievements — which, for the rest, takes place regularly; this will generally be sufficient. If not, then

(b) a proper economic policy, eliminating the temporary unemployment which else arises, and

(c) a proper policy of wages or exchange rates, eliminating permanent unemployment by opening up new possibilities of production. By a 10 % fall in the rate of exchange, for example, a 7½ % rise in the volume of employment is possible, i.e., in the case of Holland, for 100,000 labourers.

Also the inclination to turn one's back on free trade in order to fulfil one's obligations to pay *war debts* is only comprehensible from a slump mentality. There is no reason why, if full employment can be approached, paying war debts should be easier in case of protection than with free trade; on the contrary, in the latter case production is greater, so that it is easier to pay. The opinion about this in the United Kingdom is not quite clear.

On the other hand it is not necessary nor desirable to let the transition from protection to free trade take place too suddenly. Also here shocks must be avoided; e.g. by spreading it over 5 or 10 years.

CHAPTER IX. *International movements of capital.*

This chapter deals with (i) the provision proper of capital and (ii) the arrangement of war debts and reparation payments, which in many respects is analogous with it.

The significance of the provision proper of capital by countries with a surplus formation of capital to countries with a shortage is seen by us to lie in the *levelling tendency* which it makes possible with regard to the standards of living. As explained before, we see the reduction of the differences in standard of living as an important item in the programme for a consolidation of the world's economic system. Levelling by decree, by 'prescribing' that in poor countries higher wages are to be paid, can only have a very limited effect. The production of these countries does not allow of much higher wages without leading to unemployment. Consequently, unless the rich countries should be willing to present the poor countries in a large measure with an annual stream of goods — a social policy, for which the world does not seem to be ripe as yet — a *raising of production* is necessary. This may be done by (a) raising the skill of the population, (b) improving the methods of production,

(c) increasing the capitals taking part in production. On all of these three points international cooperation is desirable. In a country like China a key position is taken by the *internal political order*; as long as this is not more stable, much will remain impossible. In countries such as the South American ones the *financial stability* used to cause many difficulties. Once this has been remedied, if necessary with help from abroad, international granting of capital, the principal factor for raising production, can take place and be promoted by international *guarantees* and *control*.

This means at the same time that *formation of capital* in the rich countries must not be looked upon as undesirable and superfluous. Internal economic equilibrium in these countries is imaginable both when a larger and when a smaller share of the national income is spent. With a view to international consolidation a high quota of saving is still desirable — provided these savings are not hoarded. The calculations of Colin Clark show that, if the rise in efficiency is maintained, large capitals will be required, even more than will be formed in case the present relation between income and savings continues. Reproduction of his figures.

The war has led to great *destruction of capital* in a number of countries and further to very great debts, which are partly of an international kind; particularly the lend-lease debts to the United States. In connection with its great wealth and its safe geographical situation this country itself has suffered no great losses of capital, and is better able to help than any other country. Thanks to this a great many disastrous results of the war can be reduced to smaller dimensions. The interest and redemption on these debts will be very considerable, however, and it is questionable whether 1. the different countries will be able to bear them, and 2. whether it is in the interest of a stable and prosperous social system to maintain them. Some figures. Therefore it would be an act of wise statesmanship to strike part of these debts. After all it is also in the interest of the U.S.A., and in itself there is nothing meritorious in this country having a safer geographical position than the other allied nations.

With regard to *reparation payments* similar arguments hold good. The *actual limit* put to a country's capacity is to be found by reducing the maximum production by what is necessary (a) for the subsistence of the population (which, on the other hand, has an influence on production) and (b) for reconstruction purposes, in so far as this is necessary to continue or resume production. For Germany, we estimate this limit at approximately 10 milliard

Reichsmarks a year. They will only be able to pay this by *supplies in kind* — or some such arrangement —; payment in the usual way, with commercial intercourse left free, can only take place to a very small extent. The receiving countries ought to consider carefully whether or not they wish such payment in kind.

CHAPTER X. *Regulation of financial transactions.*

As a demand to be made on financial intercourse we formulated in chapter VI the banishment of national arbitrariness and the largest possible stability in the rates of exchange with the greatest possible freedom.

The simplest theoretical solution would be the introduction of a *world currency*, but political unity has not got far enough for this. A system of *floating* currencies leaves a fairly considerable margin for national arbitrariness; it was all right for a time when everybody had to look after his own interests. But, when nations can make up their minds to a sufficient measure of cooperation, the preference should be given to a system having in common with that of the gold standard *fixed prices* with regard to gold, and in which a *minimum of autonomous changes* can be brought about. Besides gold, the cover could also exist of government securities and warehouse bonds for raw materials. Changes, whether or not autonomous, may have to be made now and then in a world with pretty fixed prices and wages.

The rates of exchange can only be maintained, both for long and for short periods, when the *balances of payments are in equilibrium.* This is attainable by a complete regulation of financial transactions which strongly curtails freedom and is only desirable as a preventive measure. A country like Russia, owing to the state being trade monopolist, will of itself possess such an arrangement. For countries with a freer economic system the equilibrium in the balance of payments can be maintained for short terms, if only sufficient *reserves* in gold or foreign exchange are at their disposal, which can be applied as balancing items. These reserves can partly be centralized in an *International Equalization Fund*, making coordinated action possible.

The maintenance of the equilibrium *in the long run* can be attained by a correct choice of parity in the case that the rate of exchange affects the inclination to hoard, which it can have via the size of incomes. It is not always, however, that the rate of exchange is a good regulator of the equilibrium, as we saw in chapter V; it is, however, for the volume of employment. The real condition for equilibrium in the balance of payments is

closely connected with the *monetary equilibrium* at home. (Cf. Germany 1923). The demand for a correct trade cycle policy is thereby repeated, just as the international demands connected with it, viz. no autonomous changes in commercial policy and a *correct settlement of debts and reparation payments*. Payments must not be greater than the extra export surplus that can be obtained by a reasonable reduction of the standard of living. This amount can be estimated. Greater payments, with a maximum of what can be performed physically (see chapter IX), can only be made in kind, or, what comes down to the same thing, if in case of payment in foreign currency the stipulation is made that this must be spent in the paying country.

In the event of a proper trade cycle policy in the principal countries, a curtailment of the autonomous changes in commercial policy and financial intercourse, as well as a good arrangement of international debts and reparation payments, it may be assumed that speculative and refugee capital movements (compare 1929 and after) will decrease to a considerable extent.

Restoration of the gold standard or a similar system is not a return to '*laisser faire*'. Now that the states no longer leave economic life free of their own accord, it requires active supervision.

Ought the 1939 *rates of exchange* to be restored? The experiences gained in this respect after the previous war, are unfavourable: Great Britain, Norway, Denmark. In 1939 there was no economic equilibrium. The price movements since 1939 have been different, although not widely diverging for the financially important countries. The development of selling possibilities is greatly different, however; Holland is threatened by a reduced buying capacity of the German market, for which the restoration of world free trade might bring some compensation.

CHAPTER XI. *The necessity of an international centre.*

In the preceding chapters we saw that in several ways a *curtailment of national sovereignty* is necessary on behalf of an *international arrangement*, viz. in the field of commercial policy in order to prevent arbitrary limitations of import, in the field of financial technique in order to prevent arbitrary limitation of financial intercourse and changes of the rates of exchange. It appeared, moreover, that international cooperation is desirable with respect to a proper trade cycle policy, the reduction of the risks connected with capital export, the management of an international currency reserve and the control of international

cartels. In the long run the great problems of 'peaceful change', of a well-considered and undogmatic upbuilding of a world order, will also have to be tackled. In other words, we have put up a plea for a certain regulation of international economic life. We do not advocate complete *regulation in details.* Within certain countries regulation has perhaps gone too far already; some restraint will be welcome here, so that attention may first of all be paid to some points of *international regulation,* which are essential and which have sense, because:

1. some kinds of regulation only have sense, if they take place internationally (e.g. regulation of the market for raw materials);
2. arbitrariness in the international field is usually greater, in consequence of national sovereignty (commercial policy, financial intercourse);
3. the international field is less surveyable (capital market) and
4. in some international markets the price is a bad regulator (exchange market, wheat).

The nature of the proposed regulation is suggested to a greater extent by the 'liberal' theory than is sometimes suspected. For the rest, it stands or falls with the assumption that a reasonable approach to *full employment* will be attained and that *political international cooperation* shall become a fact.

The alternative to this regulation becomes clear when the history of 1919-1939 is read again.

All these arguments show the necessity of an *international centre* — with various organs — that will be an instrument of observation, of study and of management, vested with the proper power; this last point is all the more necessary, because national interests are looked after in a more organized way than in 1919. Thanks to discussions among the United Nations a number of these organs are already in a state of preparation, and it may be hoped that these plans will also be carried out further. Then it should also be hoped that the staff of the Secretariat of the League of Nations will be included, which in the past 5 years performed and published such important studies.

The organs ought not to be loose from each other; their decisions must not be incompatible. An instrument that vaults them over and can become the seat of real international economic and financial policy and that will teach the promotion of the general interest, is indispensable. It is very much to be hoped that no half work will be done, as in 1919.

CHAPTER XII. *The Netherlands and international economic cooperation.*

The position of the Netherlands among the other countries is characterized by a rather *high standard of living* (between England and the continent), a *less agrarian character* than is generally supposed and a wealth that is invested for a relatively large part in *Indonesia* and in *foreign countries.* Imports form 30 % of home production. The balance of payments shows an *import surplus,* backed by receipts from shipping, interest and dividends.

Accordingly *free trade* was always in the interest of the Netherlands, likewise a well-functioning financial intercourse and good international cooperation. Also in the non-economic field; though this was not always realised. Only hesitatingly were protective measures introduced and in 1936, properly speaking too late, the guilder was depreciated.

The *prospects for Dutch exports* are certainly unfavourable at a short date and doubtful for the further future, if compared with those of other countries. At short notice will be felt as factors on the side of supply the destruction of our production plant (industrial as well as agrarian), while increased competition is feared from e.g. Great Britain with its heavy war debts to the United States. On the side of demand the smaller demand for luxury articles makes itself felt (bulbs, chocolate), which may be offset by the increased demand for means of production (engines, dock plant) and durable consumption goods (wireless sets). As for outlets, a smaller demand from Germany will have to be reckoned with, which was our greatest purchaser, while also conditions in the Far East are uncertain. For the future we may reckon with some more favourable factors, especially appearing from the computations of Colin Clark. These justify the expectation of a greatly increased demand for refined agricultural produce, in consequence of the further industrial development of Russia, the United States and China; moreover, the prices of these goods would develop relatively very favourably. Of course, the question remains whether the possibilities as calculated by Clark will not be thwarted by a wrong mentality in business circles or incorrect government measures.

Although it would be too much to say that the Netherlands cannot do without free trade, it is evident that it would greatly benefit by a possible continuation of the tendency to free trade, which is found, for example, in the United States. By it many markets would become accessible again, to which it has a claim by virtue of its achievements. On the other hand, if things get thus far, the Netherlands ought loyally to cooperate and not to

oppose possible competition from the Far East. It must reply to this by raising its own achievements, both in the foreign and in the home markets; if this should not succeed, an adaptation of the rate of exchange or of wages is necessary. On no account should unemployment be put up with; a correct trade cycle policy is necessary.

As for *capital export,* after the period of reconstruction in which we shall presumably have to import capital, it will be possible and necessary for this to take place to a very large extent in our own kingdom. What was said in chapter IX about promoting the granting of capital to less developed territories, may be repeated here. May the political evolution be followed by a stronger feeling of responsibility in Holland itself for the Indonesian population. It is possible for the further industrialization of Indonesia to be systematically connected with the extension of that production in the Netherlands, for which there will be a demand, in proportion as the Indonesian population increases in prosperity.

As for financial intercourse, there is not the slightest doubt that the Netherlands will heartily participate in an international cooperation.

FIRST PART

THE ESSENCE

OF INTERNATIONAL ECONOMIC RELATIONS

Chapter I

INTRODUCTION

THE HETEROGENITY OF WORLD ECONOMY

The war has shown us in such a painful manner that there has been a lack of international cooperation in the years lying immediately behind us, that further demonstration is unnecessary. This lack of cooperation has made itself most felt in the field of pure politics; economic problems were somewhat more in the back-ground, especially in the last few years before the Second World War. But it appears, if one goes further back, that economic problems have played an important part in causing many of the controversies of an intricate nature, from which that war arose. And in any case, economic relations do form to such an important extent the foundation of our society that good international cooperation must of necessity include as an essential part, good economic cooperation. This essay deals with this economic cooperation. In doing this, we shall first (in the First Part) go into the essence of international economic relations; in the Second Part we shall discuss whether a certain planning of these relations is desirable, and what concrete forms international cooperation in the field of economy will have to assume. For a good idea of the essence of international economic relations, one should start from the fact that world economy consists of a fairly large number of national households; according to the way of grouping, it will be possible to distinguish from 30 to 60 such units; and of them the greater, and sometimes the smaller, are even not in the least homogeneous. In several respects these national households are

independent, or nearly independent, of each other; in other respects they are greatly dependent on each other. Each of these national households is characterized by the size of its population and that of its wealth; and there are great differences in the one as well as in the other. In other words there is great heterogenity. The wealth of a national household consists on one side of natural wealth such as land for agricultural purposes, minerals, advantages of natural means of communication, geographical position, or climate; on the other side, of the possession of capital goods, i.e. of goods partly produced by human labour, which are important for further production and consumption. The table on page 33 gives a few figures about the population and the wealth of some of the most important national households.

On the ground of the great differences in wealth in land and in capital goods as shown in this table, Wagemann, the well-known German statistician, has divided the world into four areas. By 'highly capitalistic' areas he means the areas with a dense population and a great utilization of machinery per head of the population. As the density of the population is the reverse of the quantity of land per head of the population, it may also be said that these are the countries with relatively little land (or space, if you like) and with a relatively large capital. They are chiefly Europe and the United States; also Japan. A second group of countries forms the 'half-capitalistic' area; they are poor in land *and* in capital; these are especially China and India. A third group consists of the 'new capitalistic' countries; here there is comparative wealth of land and capital; they are the Dominions and South America. The remaining territory, which in view of its population may be called insignificant and is chiefly formed by large parts of Africa, Wagemann called

TABLE I

POPULATION, AREA PER HEAD AND CAPITAL PER HEAD FOR THE PRINCIPAL COUNTRIES

Countries	Population on 31 Dec. 1938 in millions	Area in sq. kil. per 1000 inhabitants[1]	Capital in I.U.[2] per head of the working population[3]
U.S.A.	131	61	4360
Canada	11	870	4240
Gr. Britain and N. Ireland	48	5.1	5000
France	42	13.1	2740
Netherlands	9	4.0	2910
Germany and Austria	76	7.5	2670
Italy	44	7.3	1460
Poland	35	11.3	1200
Australia	7	1130	4400
Russia	170	124	1130
Japan	73	5.5	1350
India	395	12.8	580
China	500	133	180

the non-capitalistic group. It is rich in land, but poor in capital.

In each of the national households there is production: goods and services are created with the aid of the three so-called production factors: labour, nature and capital. These three production factors are the same elements which we have already discussed. The labour is supplied by the population, and the natural forces are especially those of the soil. As everybody knows, the most diverging goods

[1] About 1936; Statistisches Jahrbuch für das deutsche Reich, 1937, p. 7.
[2] Dollars with the purchasing power of 1925-1934.
[3] Colin Clark, The Economics of 1960, p. 80.

and services are produced; agricultural and dairy products such as wheat, rice, potatoes, cotton, butter etc., mineral raw materials, such as coal, oil, and iron; finished products such as clothing, houses, means of communication, and services, such as the transport of goods, the distribution of articles of consumption among the consumers, the picture shows, or the dressing of ladies' hair. If one wishes to get an idea of the total quantity of goods produced by a country, the simplest way of doing so is by assuming a certain value per unit, that is to say a price, for every sort of product, for instance the value which that article had in the United States, in a certain period, expressed in dollars. Colin Clark, the well-known English statistician, who has made many investigations in this field, has expressed the production of all countries in the amount of dollars for which those goods could be bought in the United States on an average during the period 1925/1934, that is a period with five very prosperous years, and five years of crisis[1]. The quantity of goods which is represented by one dollar in that period, he calls an international unit (I.U.). When the value of the goods produced has been calculated in this way, the goods lost in the process of production, such as imported raw materials and worn out parts of machinel and buildings etc. have to be taken into consideration. After deducting these items, apart from some complications which are not of great importance for the layman, one gets the net product (in dollars of 1925/34), which agrees with what may be called the real national income from production. (Of course the use of other units than the I.U. is also permitted). This amount, which for all countries, forms by far the greater part of the whole real national income, is a good gauge for the total quantity of

[1] Colin Clark, The Economics of 1960, London 1942.

goods which a given country produces[1]. If one calculates what this production amounts to per head of the population, very great differences appear to exist. Colin Clark mentions for instance that, calculated per head of the population, and in the supposition that 2500 hours' work is done per year by everyone, the income in I.U. in 1925/29 amounted to:

The United States	590
Canada	550
Great Britain and Northern Ireland . . .	502
The Netherlands	357
Germany and Austria	292
Poland	117
Russia	95
India (including Birma and Ceylon) . . .	64
China (,, Corea and Formosa). . .	44

Apart from an incomplete use of the productive forces, such as happens in times of depression, the differences in production per head, as further investigation shows, are very greatly dependent on the quantity of land and capital which the country considered has at its disposal. The very low figure of China, for instance, is partly connected with the fact, that in that country only about 4 acres (1.6 hectare) is available for every farm, whereas 13 acres is the most economic size. This makes it compulsory to follow methods of production which lead to a much lower return than under more favourable conditions. Further, the production is so low, because in China the quantity of capital goods, i.e. agricultural machines, cattle, and so on, is very low per head; all in all, the Chinese farmer

[1] To prevent any misunderstanding, it must be stated that by the national income from production and the total national income, without the adjective 'real', we mean the results of the corresponding calculations based on the prices of the goods in each year under consideration.

produces only $^1/_{14}$ of what his American colleague produces.

It is especially the amount of capital per head which influences the quantity of products produced per person. If this amount of capital is low, we shall also say that the capital quota in production is low; prosperity is then low too; broadly speaking, it may be said that a capital quota which is ten times as high is accompanied by a degree of prosperity which is about twice as high.

Next to that, the greater or smaller skill of a population plays a part, but this must not be misunderstood. Further investigation has shown, for instance, — as we have already remarked by the way — that the apparent 'backward' methods of the Chinese farmer are, to a great extent, a result of the smaller wealth in appliances, and that they, in the given circumstances, still yield the best return. It is a well-known fact that the learning of industrial activities in the eastern countries sometimes goes surprisingly well. For the more trained and the intellectual professions this is, from the nature of things, not so simple.

Where little is produced, there is little to be distributed, and consequently, in countries with a low production per head, the material prosperity is in accordance. Although happiness does not lie in material prosperity alone, the nameless misery hidden in the low figures for China and India is not to be underestimated; everyone who has read a description of a famine or a flood in China, can realize it.

The total product of a country is, by means of the process of exchange, finally spread over the various groups of the population. The distribution among labour, land and capital, that is to say among those who have an income out of their labour, through ownership of land, and through the possession of capital, is of great importance in this. The proportions in which this division occurs are only known

in round figures for most countries, but it seems, curiously enough, that from country to country there are no great differences in them. It can be ascertained with more certainty that in the United States and in England in the course of the preceding century those proportions have not greatly changed. Broadly speaking, it can be stated that some 70 % goes to labour, 20—25 % to capital and 5—10 % to land owners. This means, that in countries — or in periods — in which land is relatively scarce, the 'remuneration' per unit is much higher than in countries — or years — in which it is relatively abundant, and this in such a manner, that the 'total remuneration' of all land always remains about the same, whether we have to do with a country with almost exclusively farmers, or with a country which is almost entirely industrialized.

In the above lines the heterogenity of world economy is, we hope, clearly portrayed. In a few words it might be summarized as follows: China and India are the chief areas with a serious shortage of prosperity, in other words: the 'depressed areas' or, as we now say, the 'development areas' of the world.

Now between the various national households there are diverse forms of economic traffic. For the sake of convenience, we will make a rough division of them — though this, as is so often the case, is not faultless — by placing side by side:

1. The traffic of products, i.e. goods and services, which is chiefly the normal commercial traffic; here the word 'normal' means that it refers to a more or less continuous flow of goods and services, which would also exist in static conditions; and

2. The passage from one country to another of factors of production; in static conditions this would not occur.

This passage may be of

a. persons, by which we mean migration (so we are not speaking of ordinary travelling, which is of little importance for the economic problems);

b. land, i.e. changes of territory;

c. capital: the so-called import and export of capital.

In the economic sphere 2b. plays practically no part; now and then, colonies of one country have been sold to another country or exchanged for another area, but not to any important extent. In the sphere of politics they may all be of significance; after wars sometimes rather considerable changes in territory have occurred, in recent times too. In the last twenty years also 2a — migration — was of very minor significance. And even in the 19th century emigration, at least for the countries from which emigration took place, led to changes in the population of at most a few per cents yearly. For our consideration, which is limited to the economic sphere, in which there is no question of one-sided passage without a quid pro quo, it is chiefly 1. the normal commercial traffic, and 2. the import and export of capital, that are of importance. But for these too, it holds good that the production for the home market is considerably greater than that for foreign markets, and that capital formation at home far exceeds the import of capital.

We are now going to submit these forms of economic traffic to a separate contemplation.

Chapter II

CURRENT COMMERCIAL TRANSACTIONS

There is among the various national systems a multi-coloured commercial intercourse in goods and services. From tropical regions cotton, cane sugar, coffee, cocoa, coprah and so many other raw materials are conveyed to the temperate zones, whereas industrial products such as textiles, machinery, ships and railway waggons will go in the opposite direction. From countries with rich ore deposits iron, copper, zinc and many other metals flow in a continuous stream to other regions; agricultural districts will ship their butter, cheese, meat, hides and wool; horticultural areas provide other countries with a choice of fruit and vegetables. From these few examples it becomes clear already what is the origin of the exchange of goods between two nations; one people can more easily produce one kind of goods, another a different kind, all in consequence of differences in natural resources, natural ability, technical development, etc. There will be all the more reason to convey the goods produced along vast distances as they are more easily transportable, i.e. require low transport charges in proportion to their value. Very heavy goods of comparatively little value will in general not be transported so very far. Every kind of good has a certain distance — slightly varying in accordance with circumstances — beyond which it will hardly be able to compete; pig iron and potatoes, for instance, only rarely cross the oceans. Generally speaking, therefore, great countries have smaller imports and exports in proportion to their total production than small countries, as for

example is illustrated by diagram 1, which gives a survey of world trade compared with the national incomes of the principal countries. In the column of imports one can

National Income and Imports of a number of countries, 1930

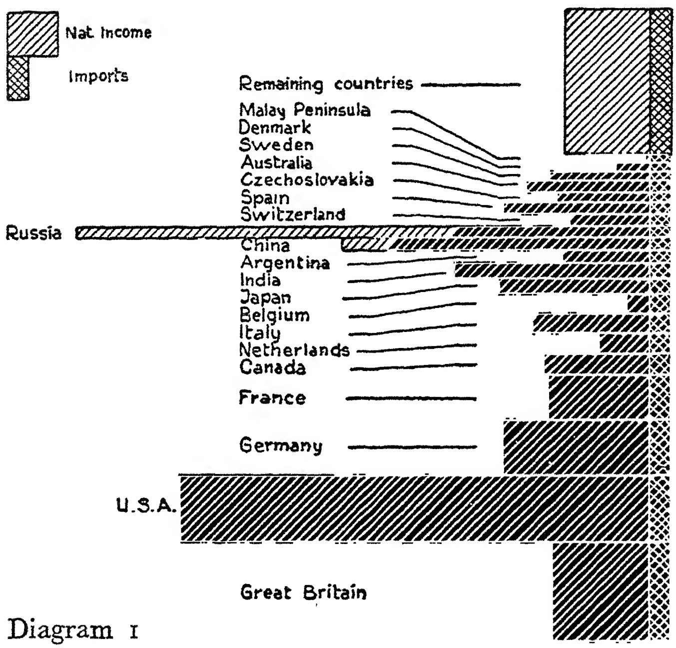


Diagram 1

The parts of the right hand column show the significance of each of the countries for the world's trade, the parts in each horizontal bar show the significance of the imports of the country concerned with respect to the national income of that country

read the relative importance of the different countries for world trade, while every horizontal quadrangle gives an idea of the proportion between imports and the national

income of the different countries. Although, therefore, a country such as the U.S.A. is of paramount importance to world trade, yet the imports of that country are only small if compared with its national income.

In order to get a closer insight into the forces controlling international goods-traffic, it should be borne in mind that every producer produces that article which brings him the highest remuneration for his trouble, in other words, that article which requires least trouble at a given value of production, or which in the present organisation of production involves the smallest expense. It does not necessarily follow that all goods will be produced there, where the difficulty of production in an absolute sense is smallest. For in that case some nations would have to produce almost everything, others nothing at all. They are produced there, where the difficulty of producing them is relatively smallest; i.e. in relation to the care to be bestowed on other products. Let us assume that, for instance, an English producer, growing wheat, produces for an amount of £ 80 a year (calculated at the prices of the world market) — and for an amount of £ 100 a year, if he makes chemical products. And let a man in the Argentine, growing wheat, produce a value of £ 60, and by making chemical products £ 50. Then the Englishman had better produce chemical products and it would be best for the Argentine to till the land. For even if the Englishman should have sufficient chemical products for himself and desire wheat, he can obtain more wheat for one man-year by offering chemical products than by growing wheat, whereas the Argentine who is desirous of chemical products can more profitably offer his wheat than run a chemical factory. It is of no consequence that the Argentine in growing wheat produces less than the Englishman; what

matters is that this still comes more natural to him than chemistry[1].

This is the so-called 'theory of comparative cost'. Countries which along the whole line have small difficulty in producing goods — which means that they can produce per head and per hour a large quantity of goods of all kinds — enjoy a high standard of living: wages and other income, expressed in goods, can be high there. The opposite holds good for countries which along the whole line have great difficulty in producing goods: only low wages, expressed in goods, can exist there.

Roughly speaking — and we pass over such complications as are of no interest for the main line of our argument — the wages in the latter countries are also low and this counterbalances the low productivity. It is an error to think that countries with high wages cannot compete with countries with low wages; in the competition of products it is the price that matters, i.e. the total cost of production, and this is, as far as the amount of wages is concerned, the product of the wages per hour and the number of hours to be devoted to the production of the article. In other words, for the possibility of an international equilibrium in trade the real wages per hour are of no account; only money wages per unit of product. A perfect equilibrium of trade is possible side by side with great differences in wages. That American machinery can compete with German in the world market, while American wages are much higher than those in Germany, is due to the far

[1] Actually the matter is more complicated; the produced value is not a constant amount, but decreases in proportion as a greater quantity of the same article is produced; sometimes it increases at first. In the present work, however, these niceties cannot be dealt with.

higher production per hour in the U.S.A.; and this again is closely bound up with the large capital quota in her production. For the same reason German industrial products can compete with Italian ones, or, in many respects at any rate, with Japanese goods.

In spite of this possibility of a perfect equilibrium going side by side with free competition, yet in practice disturbances will frequently be possible, too, as a consequence of international competition. Owing to an unexpected rise of new competitors — the chance of which is evidently greater on an international forum than within the borders of one country — production may become unremunerative which may cause unemployment. Already at an early stage this led to the idea of limiting free commercial intercourse. This limitation may be attained by a prohibition of imports, by raising import duties or by quota-systems, i.e. by a partial prohibition: in that case no imports are allowed beyond a certain maximum. This last method became widespread on the continent of Europe in the years following the 1929 depression. International trade, therefore, can take place according to more than one method: it may be left free, it may be hampered arbitrarily by protective measures, or — as it has been frequently expressed in the last decade and from different quarters — it may be 'regulated'. Without a nearer explanation it is not clear what is meant by this last expression. On closer inspection it appears that different kinds of regulation are meant by the different proposers. One form is that in which, fundamentally, people allow themselves to be guided by what would happen with free international trade, only wishing to prevent excesses. Such excesses may be selling below cost, so-called dumping, which has often been done in times of depression, when in this

way a surplus of production could be disposed of and part of the cost be recovered at any rate. In a certain sense also the too great changeability of supply is an excess, to which, with international competition, one may be exposed in consequence of crises abroad, and which may be limited by allowing trade only on the basis of long-term agreements, by which the situation is each time surveyable for a certain period. Although this would already mean a fairly great interference with the freedom of trade for the various firms individually — the simplest way of carrying this through would perhaps be the monopolizing of trade with the aid of certain cartellike bodies — yet, in this way one would not necessarily come into permanent conflict with the international division of labour according to the theory of comparative cost.

Other forms of regulation of international trade start from a division of the world into smaller areas (regions), inside which there would be free trade, but which would be 'screened off' on the outside, either wholly or partially. This kind of regulation fairly corresponds with the 'economy of large areas' as propagated from German quarters. It starts from about the same principle as the regulation, proposed by others as well, for times of depression, and which aimed at the limitation of unemployment to a minimum. This principle is that a planned economy can only be successful within an area standing under one political authority, and that this planned economy must not be traversed by measures from other self-governing countries. In other words, a certain drawback, lying in the less complete division of labour with the rest of the world, is sacrificed for the attainment of the advantage of a purposeful guidance of economic life, in consequence of which other, more desirable, purposes may be attained, such as,

for example, the utilization of all productive forces. It stands to reason, however, that by-motives of a military nature have also influenced some countries applying this method.

We have been unable to discover other principles of regulation in the suggestions which have been made in that direction, and therefore there is, fundamentally, and economically speaking, only the contrast of free trade and the restriction of it.

What are the results of these two ways of doing business among the nations? If the utilization of all productive units ('full employment of the productive apparatus') should be certain from the very outset, as the old theorists usually assumed, unhampered barter will provide the highest value of the total production. This may be illustrated as follows. We shall assume again that in Great Britain one man produces for an amount of £ 100 a year — calculated at the prices ruling in a free trade world — when he makes chemical products, and for an amount of £ 80 a year when he grows wheat. These figures show, as we already stated, that Great Britain is more suitable for the production of chemical products than of wheat. If now, in consequence of military or social considerations, protection is resorted to and the growing of wheat becomes remunerative owing to an import duty on wheat, imports of this article will decline, and at the same time the exports of another article will decline; there are not sufficient producers to see to the full measure of exports of former days. Let us assume that fewer chemical products are manufactured. It will now be evident that Great Britain as a whole will suffer from this. The people who produce for an amount of £ 80 in wheat would do better to make £ 100 of chemical products and buy wheat for that sum in the world market. There would

be a surplus of £ 20 left for them to buy other articles.

Let it be assumed further that wheat was formerly imported from the Argentine. This country will now witness a decline in wheat exports and will establish an industry of her own by which she can make for herself the chemical products formerly imported from Great Britain. In Argentina, however, circumstances are such that one man produces for an amount of, say again £ 60 of wheat or £ 50 of chemical products: Argentina is relatively more suitable to grow wheat. Also this country will now suffer; instead of making chemical products herself, she would have done better to continue growing more wheat, for every man who grows £ 60 of wheat could exchange this for chemical products in the world market and receive more for it than he could have made himself.

Only in that case does this argument not hold good when it is assumed that world market prices are not the correct standard by which to judge whether an article is worth producing. Thus it might be justly asserted that the production of opium — or perhaps even alcohol or tobacco — had better not take place, in spite of the fact that high prices may be obtained for them in the world market. It might also be argued that the prices of some articles of luxury — say oysters — are thus high, because the very unequal division of incomes unjustly grants so much purchasing power to the wealthy that they are able to satisfy their wants, whereas the humanly speaking more urgent need for clothing for the poorer classes cannot — in consequence of the lack of purchasing power — raise the price of it to such a level that more articles of clothing and fewer oysters are produced. These objections would only be of importance, if and as far as a change would be brought about by the protective measures in the

factors with which we are now concerned: if by them the production of noxious articles should be curtailed or the spreading of incomes made more equal. Hence we would not reject a kind of protection that had this effect; but nearly all actual measures of protection do not have it. Since neither the distribution of incomes of wheat producers nor that in the chemical industry differs much from the general distribution of incomes, this problem belongs to a different category.

Hence we may take it that in case of free trade an optimal division of labour is obtained. Any deviation from this optimal division of labour means that, in every country, a productive value smaller than the optimal one is attained and hence a lower degree of prosperity. It can only mean an advantage to certain groups within certain countries, obtained at the expense of other groups in the same country, because the total productive value of that country has become smaller. In other words, if full employment of the productive units is guaranteed in advance, free trade is preferable.

Should full employment, however, not be certain, protection may, within a certain country, contribute towards a rise of the degree of employment of the apparatus and therefore raise prosperity: this is the case meant by part of the advocates of 'regulation'. By this means protection may signify the breaking of the vicious circle of a depression for a given territory.

Moreover, protection may be helpful in the gradual completion of a change in structure that has become necessary. When, in consequence of newly arisen foreign competition, it is necessary to change over to another kind of production which has become the most remunerative at that moment, it may be desirable to make this change-over

a gradual one. For instance it may be desired that a production is continued which has been rendered unremunerative by competition until the workers have been able to learn another craft or have reached a certain age-limit. This may be attained by protecting the products of the branch of industry concerned; but it is not the only way. The danger of protection is that once it has been started, people cannot do without it and that the less productive work is continued, by which a crooked development is promoted.

In the third place protection may, as a temporary measure, help a new industry through the difficult first few years in which the production is still to be learned; in that case it may increase the efficiency of those productive units and make them ready for international competition. Then the term 'educative tariffs' is often used. Because they change, as it were, the data on which the international division of labour is based, they can even lead to a situation which ultimately also brings an increase of prosperity to other countries.

It follows from the above that, speaking generally and presupposing full employment, unhampered international trade is to be preferred. Meanwhile it should be realized that, also in the absence of artificial obstructions, competition in the world market is not nearly so complete as is assumed in most theoretical treatises. We already pointed out that every commodity has a certain distance beyond which it can hardly compete. Apart from this handicap resulting from the charges of transport, there is one of a different nature; ignorance with regard to the market, inertia, and an attachment to certain suppliers or countries of supply also have as a result that not every reduction in the prices of one competitor will bring him all the buyers, at the expense of the other competitors.

Composition of world trade (T) in, and world production (P) of the principal basic products

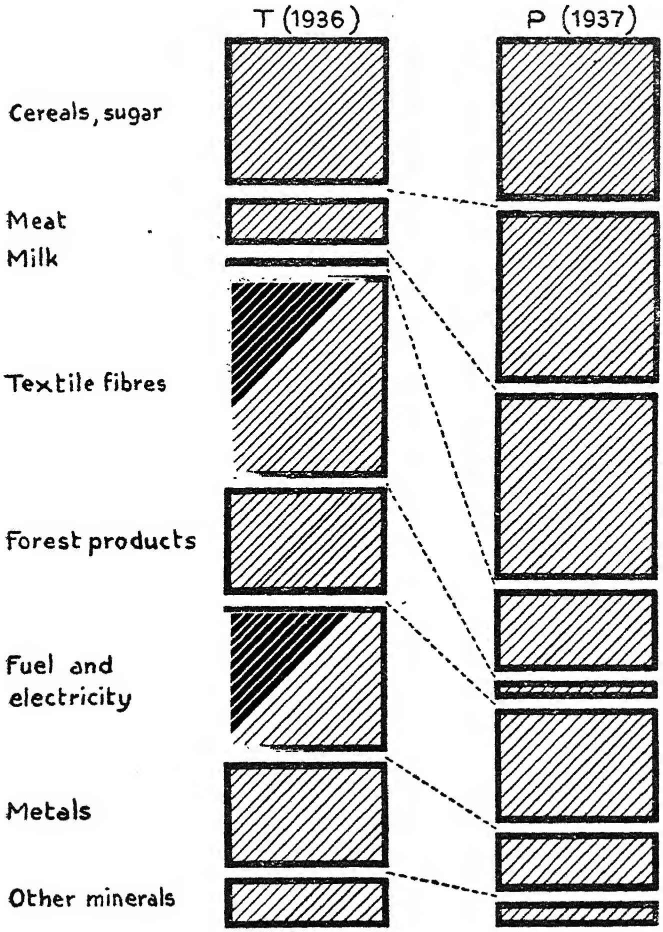


Diagram 2

Badly transportable goods such as milk play a much slighter part in international trade than in international production; for easily transportable and specifically highly valuable goods, such as textile fibres, it is just the other way about.

Nowadays it is customary to place the theory of imperfect competition by the side of that of free competition; the former is a far better approach to reality in the field of international trade than the latter. This is especially displayed in the value of the so-called quota elasticity of demand. When a competitor has a share x in the market (in which x, a figure smaller than 1, may be called his quota), this quota will be dependent on the relation y between the price he asks and the average price of all competitors, himself included. The elasticity of x with regard to y is called quota elasticity. Statistical investigations[1] have shown that the latter — it one studies changes taking place in the course of a few years — is about 2 for many articles and groups of articles in world trade. This means roughly that a reduction of y by 1 % results in a increase of x by 2 %. When a man offers at 1 % less than the market, he will by doing so attract not more than 2 % of his quota during the first few years. The theory of free competition, however, assumes that any, even the slightest, reduction of the relative price suffices to attract all customers.

After diagram 1, the diagrams 2 and 3 give some additional details regarding the structure and growth of international commerce.

From diagram 2 it appears what kind of goods are of special importance for international trade. It will be clear that these are first and foremost goods that are worth transporting along great distances; the heavy, comparatively valueless goods here occur relatively less than in world production.

[1] J. B. D. Derksen en A. L. G. M. Rombouts, De invloed van de prijs op de uitvoer. 's-Gravenhage 1939; Verdere metingen van de vervangingselasticiteit, Maandschrift v. h. Centraal Bureau voor de Statistiek, Mei/Juni 1943.

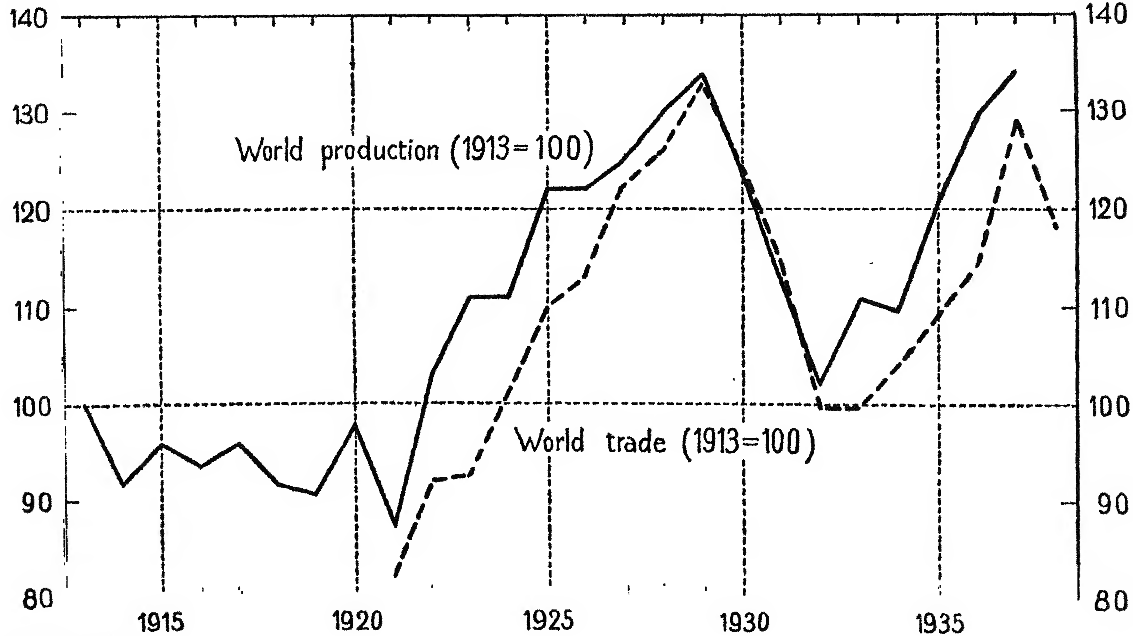


Diagram 3

Development of world trade and world production since 1913.

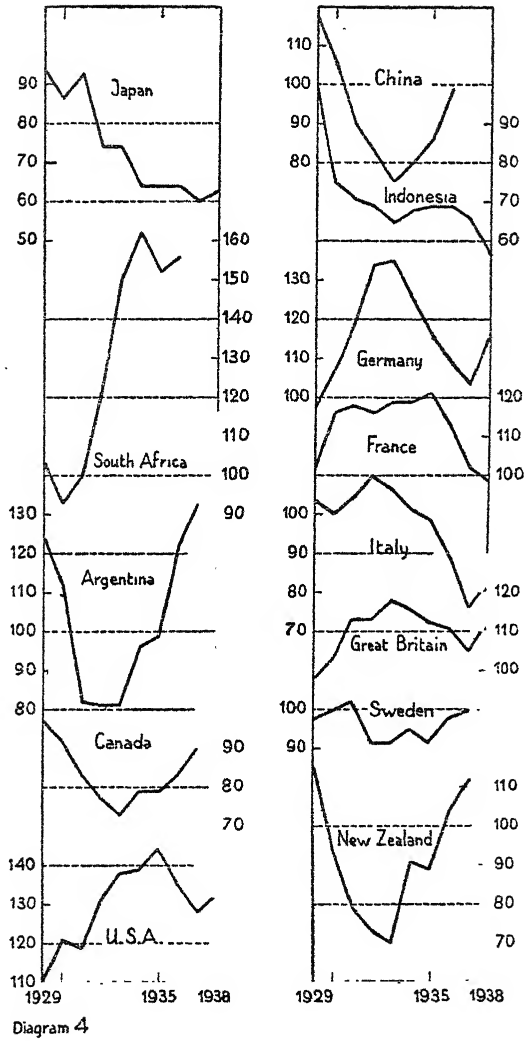
TABLE 2

AVERAGE IMPORT DUTIES IN A NUMBER OF COUNTRIES, 1913 AND 1925[1], EXPRESSED IN PER CENT OF THE PRICES OF THE COMMODITIES

	All articles		Industrial prod.	
	1913	1925	1913	1925
Argentine	26	26	28	29
Australia	(17)	(25)	(16)	(27)
Austria	18	12	18	16
Belgium	6	8	9	15
Canada	18	16	26	23
Czechoslovakia	18	19	18	27
Denmark	9	6	14	1
France	18	12	20	21
Germany	(12)	(12)	(13)	(20)
Great Britain	0	(4)	0	(5)
Hungary	18	23	18	27
India	4	14	4	16
Italy	17	17	18	22
Netherlands	3	4	4	6
Poland	.	23	.	32
Spain	33	44	41	41
Sweden	16	13	20	16
Switzerland	7	11	9	14
United States	33[2]	29	44[3]	37
Yougoslavia	.	23	.	23

Diagram 3 shows that since 1913 international trade has developed remarkably parallel with international production. It is true that in boom years it remains slightly behind the development in production, but by the end of the boom period the lost ground is recaptured and during

[1] Taux-Indices des Tarifs, publ. League of Nations, 1927 II 34, p. 16.
[2] In 1914: 16.
[3] In 1914: 25.



Changes in the 'terms of trade', i.e. of the ratio $\frac{\text{export price index}}{\text{import price index}}$ for a number of countries, 1929—1938

the depression there is hardly any difference in course between them. This is interesting in so far as it has often been supposed that trade should have undergone the depression of after 1929 in a larger measure than production. This appears to have only been the case to an imperceptible degree.

Table 2 gives an idea of the height of import duties as existing about 1925.

Last of all, diagram 4 illustrates for a number of countries the changes in the 'terms of trade', i.e. the relation, existing between the price level of export goods and that of import goods. It is evident that a country will have to work the harder for its imports as this relation reaches a lower level. From the diagram it is clear that in the great slump of after 1929 great changes occurred in that relation, which in 1937 had partly recovered. For Indonesia and Japan the development has been especially unfavourable.

Chapter III

TRANSFER OF FACTORS: TERRITORY, POPULATION AND CAPITAL

We have already remarked that the transfer from one national household to another of the factors nature (alias territory) and labour (alias population) is of no great importance in the economic sphere. The transfer of land especially is, practically speaking, never a matter of peaceful exchange, but generally an exchange compelled by force of arms. When there is also a population in the territory in question, it is generally transferred with the ground to the victorious country, which often, at least for part of the population, will mean transferring it into another nation with a different culture or language, or both. Expansion of territory in former times was often possible by the occupation of uninhabitated land; nowadays, this possibility has practically ceased to exist. Holland with its endiking of new polders is an exception to this; and here, too, the possibilities must not be overestimated: the Zuiderzee-polders will be able to accommodate the surplus population of but a few years. For a country such as Japan the difficulty of the limited area is also very great.

However, the transfer of population does occur in a peaceful form, namely as emigration. In the 19th century the population of the United States arose chiefly out of emigrants. The population of that country was in 1800 only 5 million, and had grown in 1930 to 123 million, an increase far exceeding the natural increase. As we already observed by the way, the possibility of migration, however, for the countries from which the population originated,

was generally of but little importance. Colin Clark[1] gives a number of figures illustrating this fact. For instance, the percentage of the population that emigrated from Italy, seldom amounted to more than ½ % a year; Ireland had an average of 1.5 % as a maximum, in the period 1880-1890. The figures are considerably lower for all other countries. After 1918, migration has played no important part at all; the movements of population have to a great extent come to a standstill, also as a result of there being no more land politically free. Although, as already said, this possibility of relieving over-population must not be overestimated, its restriction is a serious problem which cannot be settled by declaring the status quo to be sacred, or by maintaining it on military grounds only. We shall return to these problems in chapter VII.

From an economic point of view, by far the most important form of peaceable transfer of production factors is that of *capital*. As a rule, it takes the form of loans from one country to another — supplied and taken up by civilians, by concerns or by governments — or of participation in foreign concerns. The providing of capital can occur as long or short loans. The usual form of providing capital as long loans is by subscribing to debenture loans, or by participating in concerns by buying shares. In both cases securities are imported, as it is often put, by the country exporting the capital. Short loans can be granted in various ways, too; commercial credit can be granted, as is done more or less automatically during the process of international traffic of goods, short-credit bank balances can be transferred from one country to another for operations on the stock-exchange, or as a temporary investment, etc.

[1] Loc. cit. page 16.

We will not devote more time in this chapter to the financial side of credit relations, but give our attention to the real aspect. The immediate result in the real sphere of the supplying of long term capital is often the supply, by the country granting the loan, of machines and other means of production to the country to which credit is granted. Generally the credits and also these means of production are supplied by one of the highly developed, prosperous countries to a less developed area, such as the colonies, the Dominions, or, for instance, to the South American countries. In return, the benefiting country pays interest and redemption, i.e. places part of its production — increased by the supply of capital — at the disposal of the country supplying the capital. This often consists of raw materials and foodstuffs. So that, in a given year, we see a stream of capital-goods in movement — let us say from England to her colonies — which depends on the amount of capital which has been exported that year, or just before; in the opposite direction a stream of raw materials and foodstuffs, which depends on the total payments of interest and redemption which must be made in that year, i.e. consequently on the supplies of capital which have been made during a long period of years. Which of the two streams is the strongest, cannot be said beforehand. For a country which has just begun to export capital, the first stream is the greatest; when that process has already been going on for a very long time, and is perhaps beginning to weaken, it is quite possible that the reverse is true.

In the course of the 19th century, immense capitals were invested in this way in the United States, but that country has now become a capital exporting country itself. Since then, much has been invested in the Near East, the Far

East, in South America and the Dominions. In the period after the First World War, a highly developed country like Germany showed a considerable import of capital, which was a result of the serious capital consumption, caused by the war, and of the scarcity of capital which the financial obligations and the social policy of Germany brought with them. The economic significance of these investments is that the capital thus flows from countries where, through its comparative abundance, its marginal product and consequently the profit rate are low, to countries where, owing to the greater scarcity of capital, marginal product and profits are higher.

The prosperity of the countries poor in capital is increased by the investments, in spite of the payment of interest and redemption, since productivity and hence also wages in the little developed countries rise as a result. In this way, a certain levelling up of prosperity is obtained in comparison with what there would have been without the transfer of the capital goods.

Against this converging tendency, there are also diverging ones. A country that once has at its disposal a mighty production apparatus, and, as a result, is very prosperous — think especially of the United States — can save a greater part of its national income, and therefore enlarge its production apparatus and increase its prosperity, in spite of a certain export of capital, more quickly than a poor one can. The statistical data, collected by Colin Clark[1] show that the levelling-up in total — the two tendencies taken together — has not been very great; production per head has increased by about the same percentage per year, for most countries for which figures are known.

[1] Loc. cit., graphic annex.

Among others, in the last three-quarters of a century, it has developed more quickly in Sweden and Japan than in most other countries; more slowly in Russia, at least between 1921 and 1935.

That the levelling-process, in spite of the considerable capitals which have gradually been imported into the less developed countries, has not been greater, is connected with the obstacles which exist for the investment of capital in such distant countries. The uncertain political situation in such a country as China for instance, was a great handicap. The risks caused by it are so considerable and some experiences were so unfavourable that investors were repeatedly frightened off. The great distance as well as ignorance as to the real situation were a reason for many investors, generally speaking of course, to prefer investments in their own country. Other causes of a comparatively slow capitalization of the less developed areas lie in the slight technical capacities of the population so far — and in the numerous difficulties of currency and other financial matters. Only think, in this connection, of the many times that South American States were compelled to devaluate their currencies, or of the postponement in these countries of the payment of interest on loans. We say nothing about the more anecdotal cases of less sound financial moral, which are to be met with in the history of international furnishing of capital.

The figures on page 60 give an idea about the foreign investments of a few countries in comparison with each other, and with their national wealth.

The furnishing of capital for short loans is of much less direct importance for the broad lines of the development of production and consumption. On the other hand this granting of credit is of great importance for the maintenance

TABLE 3
SOME DATA ABOUT THE NATIONAL WEALTH AND FOREIGN INVESTMENTS OF FOUR COUNTRIES

Country	Year	Currency	National Wealth	Foreign Investments	Further data about the figures in column 5
1	2	3	4	5	6
Fr.	1913	Frs	300	45	Russia 11.3; rest of Europe 16.2; Fr. col. 4.0; remainder 13.5
Ger.	1913	Marks	350	23.5	Austria-Hungary 3.0; rest of Europe 9.5; America 7.5; remainder 3.5
Gr.B.	1914	£	16	3.76	Empire 1.78; U.S.A. 0.76; So. and Cen. Amer. incl. Mexico 0.76; remainder 0.46
	1929	,,		3.7[2]	
	1935	,,	21.5	3.8[2]	
	1938	,,		4.0[2]	
U.S.A.	1914	$	107	1.9[2]	
	1930	,,		15.2[3]	Europe 4.9; Asia 1.0; Canada 3.9; Cen. and South Amer. 5.2
	1938	,,	220	11.8	
				11.1[2]	Canada 3.7; So. Amer. 2.5; Europe 2.3; Foreign property in U.S.A. 7.9
	1943	,,		13.3	Canada 4.4; Gr. Britain 1.0; other British countries 0.4; Cen. and So. Amer. 3.3; Germany 1.3; Italy 0.3 Foreign property in U.S.A. 13.15

[1] Ger. = Germany, Fr. = France, Gr.B. = Great Britain; U.S.A. = United States.

[2] Long term investments only.

[3] Only private long term investments. Then a balance of short term investments of—1.1 and loans by the government to foreign governments (war loans) 7.7.

of the stability of exchange rates. Indirectly, the importance may be very great, because a considerable indirect influence has emanated from the stability of finance on the development of international trade. We shall return to this function of the short credits in chapter IV.

CHAPTER IV

FINANCIAL TRANSACTIONS

After having considered international economic intercourse from the side of goods, we will now discuss the financial side of it. The supplies of goods and services and of securities by foreign countries must be paid for; on the other hand payments must be received from abroad for similar supplies. Now gold is the only means of payment which is valid everywhere; unfortunately, payment in gold is very expensive and very risky: it is very heavy and must be insured on account of its high value. We are thus faced with the fact that where payment in gold is often undesired, every country has other means of payment: its own banknotes or drafts, cheques and banktransfers in its own currency, which, in principle, can in many respects be put on a level with banknotes. Therefore, practically every payment to or from foreign countries is a conversion of home currency into foreign currency, or vice versa, a so-called transfer. This conversion may be the sale of foreign banknotes in exchange for home notes, but will, as a rule, consist in the sale against a bank balance of foreign drafts or the conversion of a bank balance in one currency into a balance in the other currency. All means of payment made out in the currency of a certain country are included in the name 'foreign exchange' in that currency. The conversion of 'foreign exchange' in one currency into that of another occurs in a more or less organized manner on a market which has arisen for that purpose, called 'Exchange Market', where a certain ratio of exchange, a 'price' or a rate of exchange is effected. So we speak of the

rate of exchange of the guilder in London, the rate of exchange of the pound in Amsterdam, and so on. Unfortunately, the method of quotation followed in England is exactly the reverse of what is followed on the Continent. Here by the rate of exchange of the pound, say for instance *f* 8.—, is meant the price in guilders of one pound. In England the same figure 8 indicates the rate of exchange of the guilder, meaning: there are 8 guilders in one pound.

The rate of exchange of the guilder, like every price, is brought about on the Exchange Market, because there is a supply of and a demand for guilders there. If one wishes to survey all transactions connected with this, one ought to know all the payments which must be made in a given period by and to the Netherlands. Payments by the Netherlands mean an offer of guilders, payments to the Netherlands a demand for guilders. The whole of these payments is called the balance of payments of the Netherlands. In the same way, every country has its balance of payments. Payments can be sub-divided into a few large groups. In the first place a distinction is made between: a. current items and b. capital items.

The current items include:

1. Payments for the supplying of goods, that is for imports and exports: these are often combined under the name balance of trade;

2. Payments against the so-called invisible imports and exports, i.e. the imports and exports of services. To these payments belong, for instance,
payments for freight;
,, ,, interest on borrowed capital;
payments by tourists for services rendered to them; while also the amounts transferred by emigrants to their

families are generally included in this category, just as possible war indemnities and payments for reparations.

The capital items include payments for subscribing to issues, the purchase of securities already issued, short loans, while sometimes the dispatch of gold is considered as a payment under this head. Sometimes the dispatch of gold is considered as a separate category.

Both payments by and to the country under consideration are to be looked upon as payments in the above category; one can also say, payments made and sums received by that country. Combined in a table, in which as an example (in million guilders), also the figures are given for the Netherlands in the year 1938, the balance of payments thus includes the following groups of items:

Credit			*Debit*
Current items			
Exports of goods	1086	1465	imports of goods
Receipts, interest and dividends	317	134	interest and dividends paid
Receipts for remaining services	324	111	payments for other services
Total current items	1727	1710	total current items
Exports of gold	1027	780	imports of gold
Capital import	1006	1133	capital export
		137	unexplained balance
General total	3760	3760	general total

An example of the amounts concerned in the balances of payments of the principal countries, and the division of those amounts among the balance of trade and the remaining items is given in the accompanying survey.

TABLE 4

SURVEY OF THE BALANCE OF CURRENT ITEMS OF THE BALANCE OF PAYMENTS (INCL. GOLD) AND OF THE CAPITAL-MOVEMENTS OF THE PRINCIPAL COUNTRIES, IN MILLIONS OF DOLLARS

Countries	Period	Balance of current items[1]	Capital Movement[2]
Gr. Britain and N. Ireland	1924–29	— 340	
United States	1924–29	— 548	— 556
France (incl. overseas terr.)[3]	1927–29	— 240	
Netherlands	1926–29		— 77
Switzerland	1924–26	— 32	
Belgium, Luxemb. and Belgian Congo	1929	+ 69	
Sweden	1924–29	— 36	— 20
Japan (incl. Corea and Formosa)	1927–29	+ 91	+ 17
Italy	1924–27	— 51	
Czechoslovakia	1925–29	— 44	— 42
Hungary	1924–29	+ 52	+ 51
Poland	1924–29	+ 47	+ 59
Union of S. Africa	1924–29	+ 44	
Indonesia	1925–29	— 45	— 16
Argentine	1924–29	+ 145	+ 98
India	1924–29	+ 67	
Australia	1924–29	+ 181	+ 86
Canada	1924–29	— 114	— 94
Germany	1924–29	+ 677	

[1] — = cred. bal.; + = deb. bal.
[2] — = cap. export; + = cap. import.
[3] Without Indo-China.

Source: League of Nations, Balances of payments, 1930, p. 11–15.

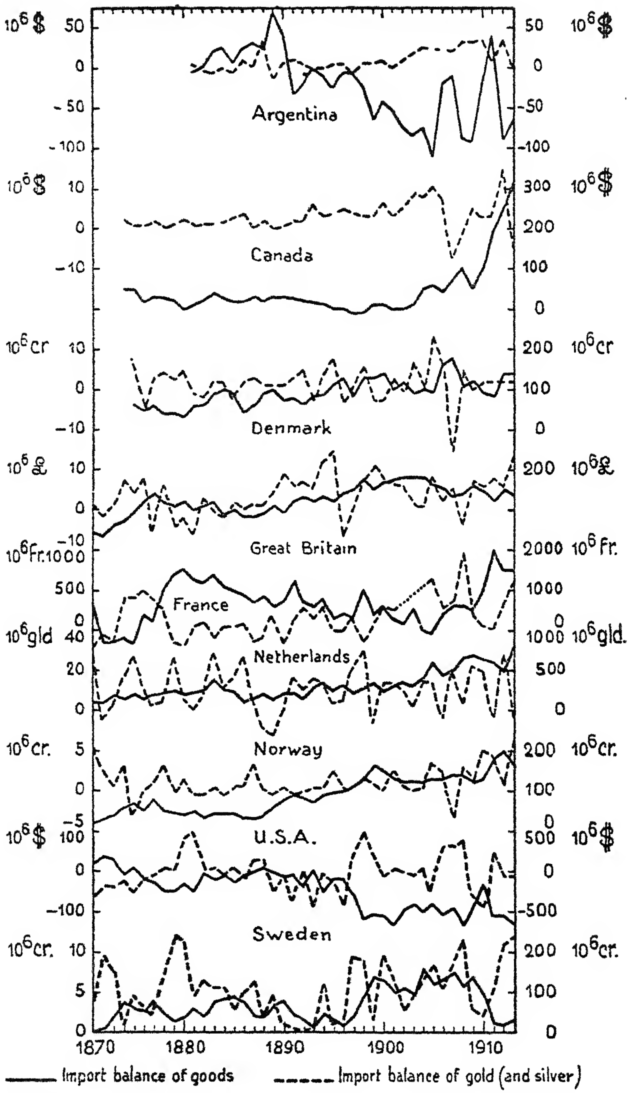


Diagram 5

The course (from 1870 to 1913) of the balances in the balance of trade and of the import-balance of gold. There is a tendency towards contrasting fluctuations, which means to say that as a rule an import-balance of goods was partly financed by goldshipments.

Further, fig. 5 gives an example of the movements, for a series of years, which have occurred in the balance of trade and the imports and exports of gold. Unfortunately, there are no data available about the other items of the balance of payments for a long series of years. One can see from this diagram that when the import-balance increases, this is generally accompanied by an increase — be it quantitatively smaller —in the exports of gold. So the increase in the import-balance is partly financed by the sending of gold, partly by other items.

In conclusion, fig. 6 gives an impression of the changes in the gold stocks of the principal countries since 1913. Whereas before that year the mutual proportions remained about the same for a long time, since that time this has no longer been the case, in consequence of the many disturbances to which international traffic was then subjected.

The gold consignments are to be looked upon, if one wishes to do so, as a closing item, a balancing item. The same can be said of the capital items, especially short credits. It is not possible to draw the line sharply; in every discussion on this point an understanding must first be arrived at. Sometimes the term balance of payments is also used for all the items mentioned except these balancing items.

If the term is used in the first sense, there is always 'equilibrium' in the sense of equality between payments and receipts. A simple example may illustrate this. If, during a certain period, *f* 800 million has been imported and *f* 700 million exported, then the country must buy foreign currency to the value of *f* 800 million to pay for the imports, whereas only *f* 700 million in foreign currency has been received for the exports. Consequently not

Gold stocks of Central Banks
in % of the total amounts in the principal countries

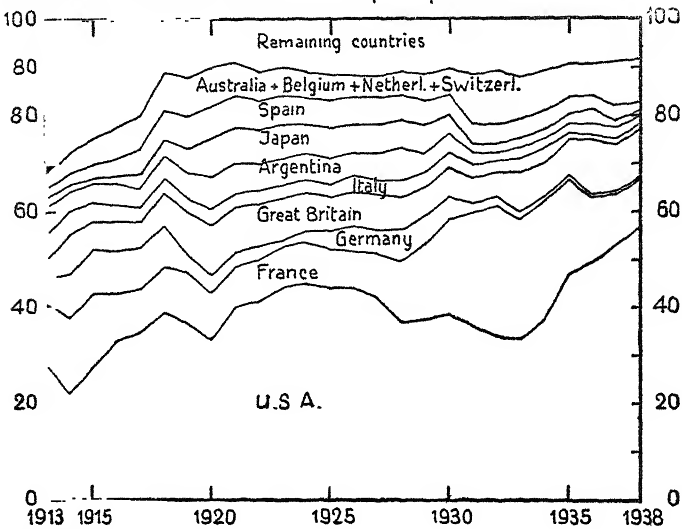


Diagram 6

Since 1913 the U.S.A. have attracted an ever increasing part of the world's gold stock; after 1933 this has been largely refugee capital.

sufficient foreign currency has been received; the balance will have to be settled either by a consignment of gold, or it may be by another £ 100 million of foreign currency being placed at our disposal. The latter can take place by a new credit being opened for us for that amount; it may also be that we still have balances in foreign currencies of which we can make use for this amount. In either case, however, an import of capital has taken place. Since both gold consignments and the import of gold belong to the balance of payments in the wider sense, there is, then, always automatically a state of equilibrium.

If, however, the items looked upon as balancing items are not included in the definition (balance of payments in the narrower sense), there need not always be equality between payments and receipts. In the long run, there will also have to be an approximate state of equilibrium between the items of this balance of payments in the narrower sense; for a great difference maintained for a long time would mean that, in the country under consideration, either a continuous accumulation of gold and foreign exchange or a complete exhaustion of those reserves was taking place, and that can only be the case within comparatively narrow limits. Nevertheless this phenomenon can occur, to a moderate extent, for a comparatively long time at a stretch; just think of the almost continuous increase of the gold stock in the United States between 1919 and 1939, especially after 1929. And the increase of the gold stock which has been taking place in the course of centuries means that in a country not producing gold itself a small import of gold has on an average always been taking place. In comparison with the fluctuations of short duration, these permanent ('secular' as they are called in statistical language) imports and exports of gold or foreign exchange may be neglected, and that we shall do for the sake of convenience, for the time being.

In the long run, the same equilibrium which must exist in the balance of payments (in the narrower sense) of a country, must just as much, and for analogous reasons, exist for every arbitrary part of a country: for it is equally hard to suppose that a continuous accumulation, or exhaustion, of gold and exchange stocks should occur there. The difference between the two cases is that in the case of a whole country with respect to foreign countries, the rate of exchange of the currency could be changed in order to restore the

equilibrium at short notice, whereas such an aid is not available to part of a currency area.

For the certainty of trade and investment calculations, stability of the rates of exchange is an advantage; then one risk is reduced to small proportions, namely, the risk of loss by a fall in the rate of exchange. On the other hand, stable or, if one likes, immobile rates, when they are accompanied by comparatively stable prices and wages at home, can give rise to a sharpening of the movements in the volume of trade. In the last decades, this has given rise to the idea that the rates of exchange could be utilized for regulating the level of home activity. Accordingly, two systems of currency-control are thinkable:

1. a system of stable rates of exchange,
2. a system of so-called floating currencies, with variable rates of exchange.

With 1. it is possible to imagine a system, by which the currency unit is made interchangeable — under conditions to be described later — with a fixed amount of gold; then we have to do with one of the forms of the gold standard. With the pure gold standard — which no longer exists — gold also circulates at home as legal tender. With the gold base standard, gold is used exclusively as cover for the banknotes concentrated at the Central Bank, and is only exchanged for banknotes or balances, if payments to foreign countries have to be effected. With the gold exchange standard even this stock of gold — which does not yield any interest to the Central Bank — is replaced by a stock of foreign exchange of countries which have the gold standard, and which can, therefore, in a certain sense, be placed on a par with gold. Moreover, it yields

interest against which, however, there is the risk — which was very actual for Holland in 1931 — that these foreign exchanges lose contact with gold. But, one can imagine other standards; for instance, inconvertible paper money; of which, for instance, the purchasing power at home is kept stable. With such a standard one will often find Government debentures as cover at the Central Bank. Confidence in the currency is then not based on a gold stock, but, if one likes, on the solvability of the country in question. In a certain sense, this is maintained by the productive capacity of the country in question; this standard is sometimes called 'the labour standard'. The contrast with the gold standard is not so great as people would sometimes like to suggest; it is often a matter of lack of gold and nothing else. Further, there are numerous mixed forms and intermediate forms. We shall return to a few of these later.

On the whole, preference is given to stable rates of exchange; there will be a special inducement for this, when, by means of a good, internationally co-ordinated economic policy, it has been possible to regulate home activity, also in the case of these stable rates of exchange.

We will now consider, more in detail, the mechanism of the various currency systems, the gold standard to begin with. As appeared from what we have already said, with the functioning of a monetary system more than one purpose is aimed at, and these ends, moreover, are not the same for each system. Speaking very broadly, it may be said that those ends are the correct providing of home and foreign economic intercourse with means of payment, and perhaps the influencing of the level of activity. In war-time, there is also the end, generally rejected for days of peace, of supplying the state with the necessary means of payment.

It will be clear that in this essay the providing of foreign traffic with means of payment will receive most attention. In the gold standard systems, this task is taken to imply that, while maintaining a fixed price for gold, and hence approximately also for the other currencies attached to gold, sufficient means for balancing must be provided, in order to make it possible to assist at short notice in cases of a disturbance in the equilibrium of the balance of payments (in the narrower sense). The one as well as the other requires a sufficient stock of gold (with the pure gold standard and the gold base standard) or of foreign exchange (with the gold exchange standard); by which 'the protection of the gold stock' is an important task imposed on the functioning of the system.

We have already said that with the gold standard there is a fixed ratio in which home tender can be exchanged for gold. If the Netherlands and England, for instance, both have the gold standard, there is in Amsterdam a constant ratio between the guilder and gold, and in London between the pound and gold. The corresponding rate of exchange between the guilder and the pound is called parity. A little above and below this parity lie two other rates which are called gold-points. If the pound stands at the highest gold-point, it pays to send gold here in settlement of a debt in pounds in England; the extra expense attached to this consignment just balances the higher price which would have to be paid for a paper-pound. If the pound should rise even more, then naturally it pays still more to do so. If the pound is at the lowest gold-point, then it pays an Englishman to send gold from England to the Netherlands in settlement of a debt in guilders there. When the rate of exchange lies between the gold-points, then it does not pay to send gold in either direction. In normal

circumstances, the gold-points lie very close together; the rate of exchange will only lie between them and remain there with a rigorous equilibrium in the balance of payments (in the narrower sense). There are continually disturbances which threaten to bring the rate of exchange outside these gold points; if the result is that the gold point is reached, then movement of gold takes place. This leads to the balancing of the balance of payments (in the broader sense), and, at the same time keeps the rate of exchange stable at one of the gold points. Should the disturbance last long, then the movement of gold could continue till one of the two sides — either the Netherlands or England — should be threatened with exhaustion of the gold stock, and hence with the impossibility of further balancing and of maintaining the rate of exchange anywhere near parity. This will be prevented long before it gets so far, and there are various possibilities of action; we will begin by making a distinction between (a) indirect and (b) direct action.

Indirect action can still further be divided into (1) automatic and (2) intentional. Automatic action is the one resulting from the change in the quantity of means of payment which the gold consignment may imply. Reduction of the gold stock may lead to a decrease of the money circulation, and that to a lowering of the national income; this, in its turn, means smaller imports and lower prices, which leads to an increase in exports. And so the inclination to a recovery of the disturbed equilibrium in the balance of payments comes into action. This automatic action works slowly and poorly, however. The Central Bank need not reply, for instance, to a reduction of its gold stock immediately by reducing the circulation of banknotes and the balances of the private banks, and

these banks need not immediately restrict their advances. Especially when the gold stock is plentiful — larger than the prescriptions for cover require — there is no immediate necessity for doing so. Decrease of the granting of credit further means a decrease of new investments, and so of employment in, for instance, the building trade and the metal industry. However, some time will elapse before the necessity to import becomes less on this account, and still more time before prices fall appreciably. It will be a matter of several months. So there is, at short notice, not much to be expected of this 'automatic indirect action'.

The 'intentional indirect action' for the protection of the gold stock consists in a raising of the discount on drafts, i.e. of the deduction for interest which is applied in granting credit on drafts; the interest for other forms of credit rises, as a rule, at the same time. To a certain extent, the same results are achieved as described above, by the automatic action, and just as slowly; the higher interest rate leads to a decrease in the demand for commercial and industrial credit, and so, too, to a lowering of incomes, of prices and of imports. Apart from that, however, another consequence makes itself felt: a flow of short credits from abroad, which can now make a higher interest. Naturally — this holds good for every consequence of every action — counteracting factors can nullify this consequence; when the raising of the rate of interest is looked upon as a sign of weakness of the currency in question, it can have the opposite effect. Such a thing, however, only occurs in abnormal times. The short credits flowing into the country fill up the gap in the balance of payments, by which an immediate recovery of the equilibrium is obtained. This means can, however, from its nature, not continue to be of a help; a point comes at which the available short credits

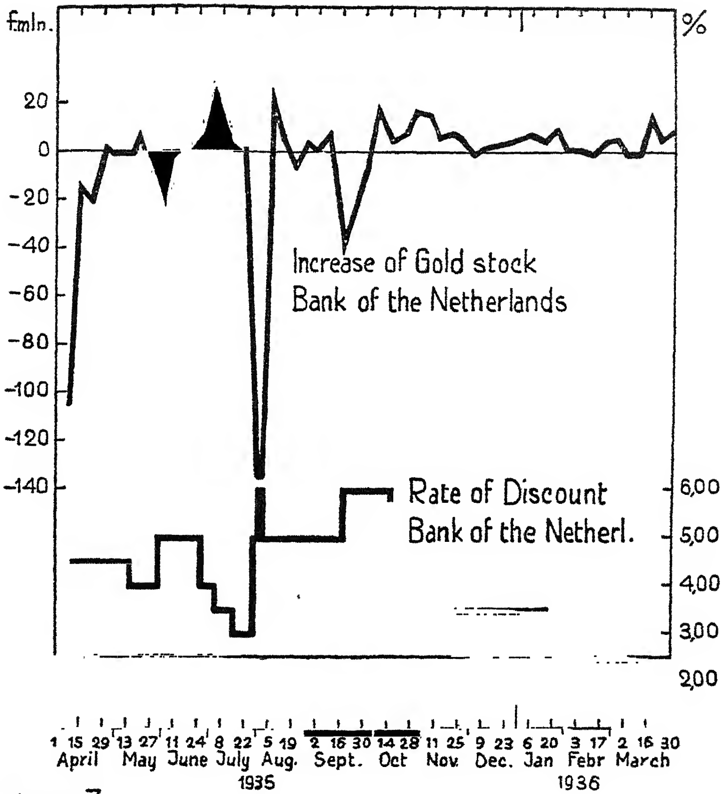


Diagram 7

An example of classical discount-policy.

are absorbed and a state of equilibrium belonging to the new rate of interest has been established in the distribution of the short credits among the various countries. Against a permanent shortage in the balance of payments (in the narrower sense) this means cannot be of much help: its effect is only temporary. Fig. 7, in which the gold stock and the discount rate of the Netherlands Bank for the

year 1 April 1935—1 April 1936 is represented graphically, gives a good example of the working of the discount policy. In that disturbed year, when the guilder was one of the few currencies belonging to the so-called gold block and still had the old parity, there were repeated withdrawals of gold, which were promptly answered by a rise of the rate of discount. Although, in this case, factors of a somewhat abnormal nature gave rise to the disturbance of the equilibrium — waves of speculation against the guilder, based on the expectation that, in the long run, it could not maintain itself — the working of the discount-mechanism was clearly noticeable, all the same.

Next to these indirect methods of protecting the gold stock, there is the direct one, which consists in stopping the gold issue; however, this also means the end of the gold standard in one of its free forms. The rate of exchange can now only be maintained further by taking control of the whole currency market, or important subdivisions of it, by which certain payments can be postponed, till sufficient currency is available. This is the method, applied in its most perfect form by Germany after 1933, and, in less stringent forms, elsewhere too. If one does not take recourse to such a regulation of currency, the stopping of the gold issue will result in the market equilibrium only being possible at a lower level of exchange.

For the rest, it is clear that the danger of exhausting the gold stock, against which the various means now discussed are intended, is all the slighter, when there is a larger reserve at the Bank's disposal, a circumstance which can be utilized in an international regulation of the balances of payments, by instituting reserves coupled internationally.

We have already mentioned above, that there are also mixed forms of the gold and other standards. In a certain

sense, the gold exchange standard which was already mentioned by the way, is of this type; next to it is an important variant, the so-called raw material standard. In this, not only gold, but also a definite parcel of raw materials is recognized as cover for the issue of banknotes. Against the handing in of a certain quantity of raw materials — or the documents stating the ownership of them, warehouse warrants — in a fixed mutual proportion, it is possible to obtain a balance at the Central Bank, or payment of banknotes; or, the reverse can take place, the Bank can receive back banknotes by the sale of these warehouse warrants. The result of this is, that the price of such a 'parcel', i.e. a certain average price level of those raw materials, remains constant in relation both to gold and the currency unit. There is nothing new to be told about the 'defence' of the cover in these cases; the same methods will be used as in the case of the gold standard.

Also the difference between a floating currency and the gold standard is more a difference of degree than of principle. A floating currency which has not actually degenerated, because the authorities have lost control of it — as may be the case with serious inflation; just think of the German mark between 1919 and 1923 — will, all the same, only fluctuate between certain limits, though these will be appreciably further apart than the gold points in the case of the gold standard. For the rest, the limits can be extended or narrowed according to choice. For the guilder after 1936, depreciations of between 18 % and 22 % had been taken as limits. Of course a difference is, that here the fixed points need not be known in advance, and can be changed gradually. With a floating currency it is possible, in principle, to maintain the equilibrium continuously simply by changing the rate of exchange; but for the

slighter fluctuations in the balance of payments this will not be done, as a rule, because the movements of the rate of exchange would become too uneasy. So here, too, a reserve of means of payments will be kept — gold and foreign currency — often called 'equalization fund', by the operations of which the smaller fluctuations in the balance of payments are absorbed. In the long run, however, influence can be exerted on imports and exports, and hence, on the level of activity, by changing the level of the rate of exchange: a lowering of this rate will facilitate competition with foreign countries, at least for a certain number of years, and, with it, raise the level of production. By making the movements only gradual, it will be possible to avoid the rise of speculative demand for, or supply of, currency. It is true, speculative purchasing or selling can sometimes accelerate the achieving of equilibrium; when, in 1924, Denmark and Norway conceived the plan, with a depreciation at that time of about half the original parity, again to restore the old parity in the long run, this level was reached in a much quicker tempo by speculation than was the intention of the authorities. Generally, however, speculative movements make the reaching of a state of equilibrium difficult, as was the case with the German mark especially in 1923; and that was a distinct disadvantage. The rapid reaching of equilibrium in the case of Denmark and Norway was not an advantage in every respect either; home activity suffered from it, because home prices could not adapt themselves to things as quickly as the rates of exchange.

Chapter V

THE EQUILIBRIUM IN THE BALANCE OF PAYMENTS

In the former chapter we have explained how disturbances in the equilibrium of the balance of payments (in the narrower sense) are avoided by daily manipulations. Now we will consider, on a somewhat broader foundation, the problem of how that equilibrium can be maintained in the long run.

Let us, for that purpose, first imagine a world in which all economic magnitudes would immediately and fully adapt themselves to changes in the 'data', i.e. in the given circumstances within which economic life takes place. We must count among these data the parities of the rates of exchange which form an arbitrarily chosen institution. Should these parities be changed, it would be without effect on the actual course of events in such a world, that is to say, on the level of production and consumption, on the relation of prices, and on the equilibrium between all kinds of magnitudes, i.e. also on the equilibrium in the balance of payments (in the narrower sense). If the parity of the guilder were to be halved, for instance, all prices, wages, etc. expressed in guilders would be doubled; in the mutual relations nothing would change, production which paid would continue to do so, and to the same extent too. The wages demanded by workmen, expressed in goods, would not change, and it would be possible for the state of equilibrium in production, in the spending of incomes and in the balance of payments, to be maintained.

Neither would the actual course of events change at all, if the parities of all countries were to undergo a proportional shifting with respect to gold, and the prescribed cover be changed in the opposite sense; if, for instance, all parities were to be raised 25 %, that is, were to change in the ratio of 4 : 5, and all prescribed covers lowered 20 %, that is to say, were changed in the ratio 5 : 4. Then the gold stocks would be in a position to cover just as many guilders, francs etc. as before, and all prices, wages etc. in guilders or francs etc. could remain the same. As there was equilibrium with the former relations of prices, so there would also be equilibrium in the new situation.

In a world in which all adaptations take time, there will be, on the contrary, some period of disequilibrium in case of a change of data, and so also of parities. This will, however, be imperceptible, or to put it more accurately, just as little perceptible as people themselves want it to be, if the change in data only takes place slowly enough. Then also the slowest magnitude will have time to adapt itself, before the change in data has become perceptible. It is to be seen from these considerations that slow changes in rates of exchange are of no importance for the equilibrium in the balance of payments; there can be equilibrium in the balance of payments whatever the rates may be, because the other magnitudes — prices and values — have the opportunity to adapt themselves. With this state of things — so, either in a world which can adapt itself quickly, or with slow changes in parity — the parity may just as well be fixed arbitrarily, without doing any harm to the equilibrium. This is even to be somewhat preferred for other reasons; for instance, on account of the greater certainty in all kinds of calculations. Hence, in the past, the rates were fixed in this way, as we have seen; they were attached to

gold by fixed prices, which were characteristic of the gold standard.

In the reality of present economic life, however, there occur numerous immobile or but slightly mobile magnitudes: these react only after a certain delay, and often not to a sufficient extent to restore the equilibrium. It is well-known for instance, that the level of wages in England adapted itself only very slowly and to a limited extent to the bad economic state of affairs in that country between 1923 and 1929. Also so-called fixed expenses adapt themselves extremely slowly: here we are thinking of interest and redemption of debenture loans, of rates and taxes and some tariffs of government services. A third example, partly included in the former, is found in all payments not directly connected with the economic situation; in this group come, for instance, some political obligations: interest and payment of war debts, part of the indemnity imposed on Germany at the time, and also payments by one public authority to another in one and the same country. In such an entirely or partly immobile world it may happen that the price of the currency has an influence, also in the long run, both on the extent of activity at home, and on the equilibrium of the balance of payments (in the narrower sense). For a lowering of the rate of exchange means that the prices of the export products abroad become lower, with the result that sales increase. This will lead to increased incomes in these branches; hence the whole national income will rise. It is true that imports may rise, too. For there are two opposite tendencies at work with respect to imports. On the one hand, the level of price of imported goods, measured in home currency, will now become higher, and this will make people chary of imports. On the other hand, incomes have

also become higher, and this stimulates the demand for all goods, also imported ones. Moreover, from a purely technical point of view, the increased production of articles of export will lead to increased imports of raw materials. It will be mostly considered as normal that the increase in exports, expressed in value, is greater than the increase in imports. Then the lowering of the rate of exchange has led to an increase in home activity and, at the same time, to a recovery of the equilibrium in the balance of payments.

If in a world which was practically immobile, the rate of exchange should also be immobile, this possibility of restoring the equilibrium would be lacking. Either the rate of exchange or the system of prices must be mobile in order to make a recovery of a disturbed equilibrium in the balance of payments possible. Mobility in both, although it looks as if that is the greatest guarantee for recovery of equilibrium, is not so desirable. For it may give rise to too much uneasiness; the chance is then greater that the movements towards recovery of a disturbed equilibrium overshoot the mark and give rise to strong fluctuations.

When the prices at home are perfectly immobile, and the rates movable, the so-called purchasing-power parities will be established as parities; broadly speaking, this means that, for instance, a guilder corresponds with as many Belgian francs as are necessary to buy the same quantity of goods in both countries.

Regulation of home activity and of the equilibrium in the balance of payments (i) by means of changing the rate of exchange or (ii) by means of adapting wages are not really identical in their working, as is sometimes said. Then it is reasoned: a lowering of the price of the guilder, for instance, means, through the rise in prices by which

it is accompanied, a lowering of real wages, and although the level of wages in money has remained the same, actually it comes to the same as a lowering of wages. But this is only correct to a certain extent. With a decrease in money wages it is in the first place the man who works who bears the burdens. His real income falls. It is true, the unemployed profit by this; for them it becomes possible to find employment; but also non-workers will in general profit by the situation, or suffer fewer disadvantages from it than the workers. With a fall of the rate of exchange, the prices of all goods rise, and now workers and non-workers bear the burdens together, to the benefit of the unemployed. That is clear especially with respect to those drawing interest; it is not so certain in the case of entrepreneurs. To this difference in the distribution of the burdens — which, for the rest, must not be exaggerated — is added another difference, one of importance for all concerned. A drop in wages leads to a fall in prices, and consequently to a somewhat expectant attitude on the part of buyers. On the other hand, a fall in the rate of exchange means a rise in home prices and with it rather a certain desire to buy. So these speculative forces act in the first case deterrent, and, in the second case, favourably on the volume of production.

We saw that in a world with only slightly mobile prices, wages etc., the rate of exchange is a regulator of employment, and possibly of the equilibrium in the balance of payments. The emphasis must here lie on the possibility. Further investigation teaches us that it may also be that the rate of exchange is not a good regulator of the equilibrium in the balance of payments (in the narrower sense). We already saw above that with a fall in the rate of exchange, exports will rise, whereas two opposite influences act on

imports. It is therefore not easy to say, without further calculations, what the balance of trade will do. These calculations show that it depends on various so-called elasticity coefficients, what happens with the balance. If exports and imports are very elastic with respect to changes in prices, and hence also to changes in the rate of exchange, exports will rise and imports fall. If that elasticity is not so great, the other forces which act on imports, may gain the upper hand, and imports will rise too. This holds good for the quantity of goods imported as well as — a fortiori — for the value, expressed in home currency. For the value is the product of quantity and price, and the price, expressed in home currency, also rises in consequence of the fall in the rate of exchange. Now it can even happen, with very low values of export and import elasticities, that with a fall in the rate of exchange, the value of imports and of exports rise to exactly the same extent. Then there is no change in the balance, and, if the balance of payments was not in equilibrium before, it will not be so either after the fall in the rate of exchange. To put it differently: the fall in the rate of exchange has not contributed anything towards the recovery of the equilibrium in the balance of payments. This state of affairs can be represented graphically, as is done in diagram 8, where the rate of exchange is plotted along the horizontal axis and the value of exports (i.e. receipts) and imports (i.e. payments) belonging to each value of the rate of exchange is plotted along the vertical axis. In the case considered as normal by the classical theory, both lines have the opposite direction (see A) or, at any rate, the slope of the import line is, in the absolute sense, slighter than that of the export line (B). In the new case just discussed, the lines have the same direction (C), while it is even possible that the import line shows a steeper

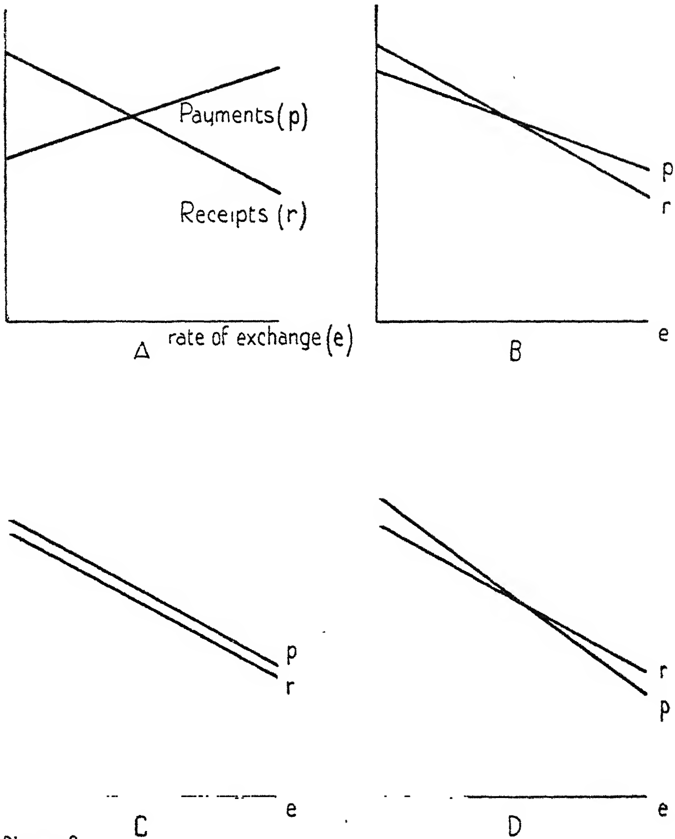
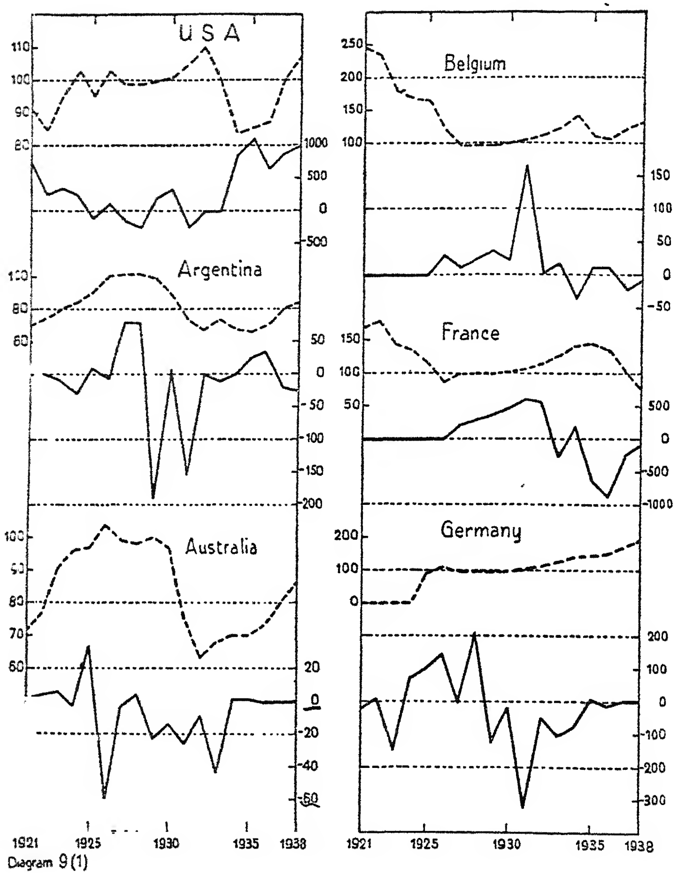


Diagram 8

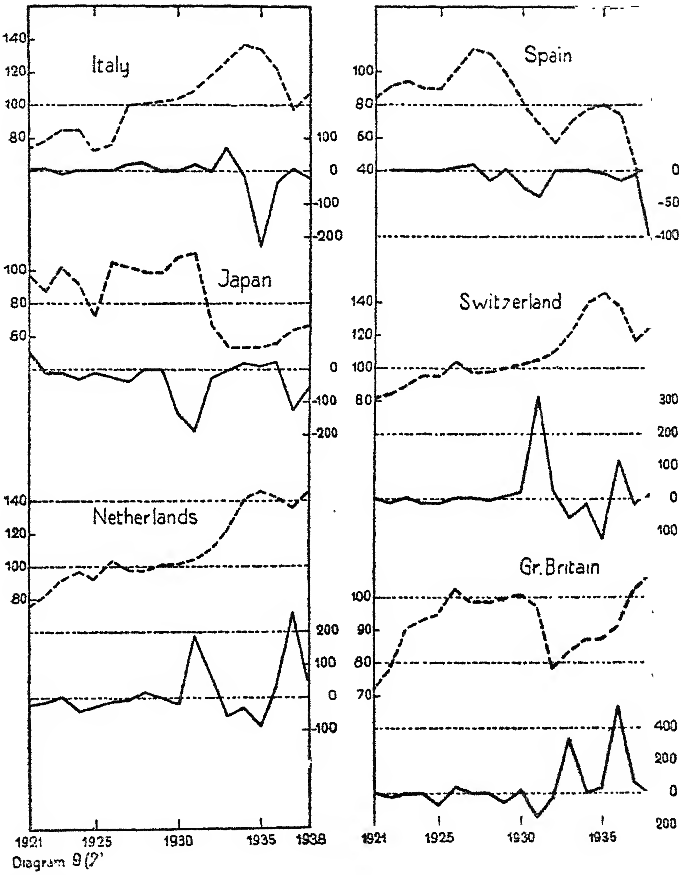
Different possibilities with respect to the mutual position of the curves of supply of and demand for foreign exchange.

course, in an absolute sense, than the export line, and just as this, a negative slope (D). Now we have already pointed out in chapter II, that the elasticities of imports and exports have proved to be much slighter than was formerly thought to be the case. To this can be added the fact



Relative rates of exchange (- - - -) and changes in gold stocks (—); annual figures.

that they depend on the nature of the goods imported or exported. A country importing articles of luxury will have more elastic imports than a country only importing the first necessities of life, and raw materials for them. The



Relative rates of exchange (- - - -) and changes in gold stocks (—); annual figures (continued).

statistical calculations known so far justify the supposition that, by approximation, such cases as of type C really do occur. In these cases, other circumstances remaining the same, a fall in the rate of exchange does not lead to a recovery

of the gold stock. A provisional and rough investigation into the occurrence of case C can take place with the aid of fig. 9, where, for a number of countries, the relative rate of exchange and the change in the gold stock, from year to year for the period 1921–1938, are graphically set out. By the relative rate of exchange is meant the rate of exchange divided by the average rate of exchange of all countries. We have taken this relative rate of exchange, because the lowering of the rate of exchange of country A must not only have an influence on A's balance of payments, but also on the balances of payments of all other countries. After a relative fall in the rate of exchange one would expect the gold stock to increase, after a relative rise in the rate of exchange the gold stock to decrease. Now there is never a guarantee that, at the same time, other factors have not changed which could explain a deviating action. The probability of a clear influence of such disturbing factors is, however, all the slighter, the greater the changes in the rate of exchange are, that we have to do with. And so it will be of especial importance to look at the consequences of the greatest changes in the rate of exchange. Fig. 9 shows us that the 'normal' reaction (rise of the gold stock after a fall in the rate of exchange) occurs in most cases: England 1932, Japan 1932, United States 1933, Italy and the Netherlands 1936, France 1937; the case in Belgium in 1935 is dubious, while the 'abnormal' reaction is met with in the Argentine 1930/1, Australia 1931/2, Spain 1929/32 and 1937, and Switzerland 1937. It is possible that for agricultural countries greater disturbances from other quarters must be reckoned with; yet the possibility of the 'abnormal' reaction, as we see, is not excluded. From the fact that, after England had gone off gold, such a strong fall in the rate of exchange followed, we may conclude that

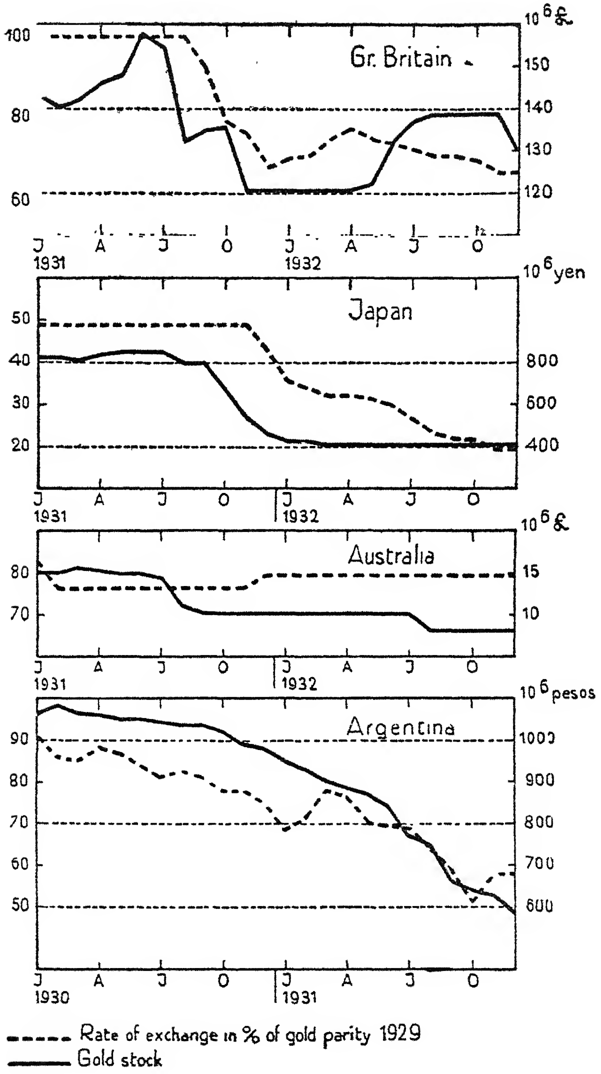


Diagram 9(3)

Relative rates of exchange and changes in gold stocks, monthly figures.

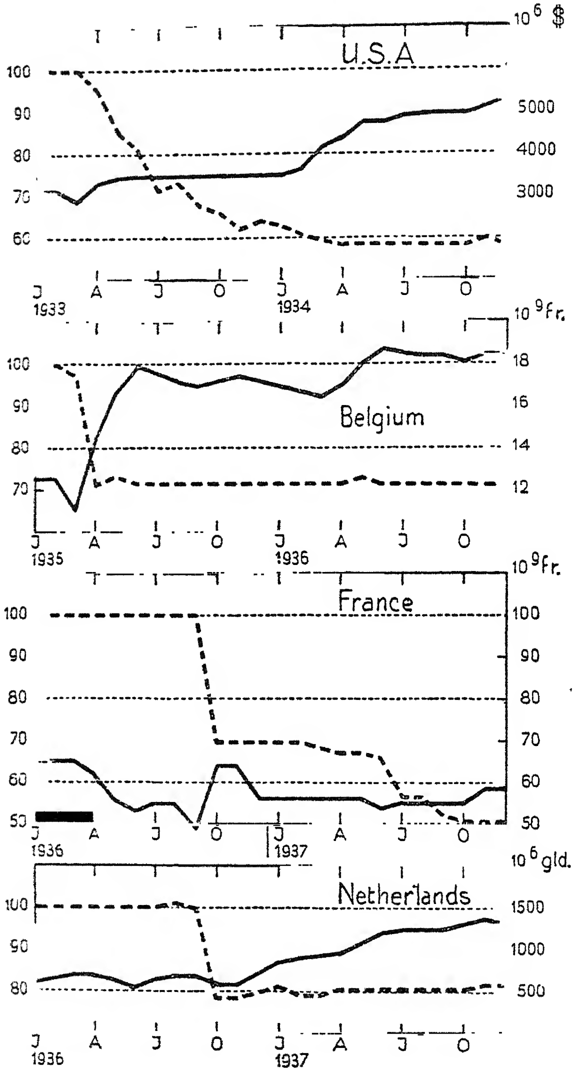


Diagram 9(4)

Relative rates of exchange and changes in gold stocks; monthly figures (continued).

apparently a strong fall in the rate of exchange was necessary to fill the gap in the balance of payments: a fall in the rate of exchange, much stronger than one was prepared to expect on the ground of earlier estimates of the overvaluing of the pound. Also this fact points to a bad regulating of the equilibrium in the balance of payments by the rate of exchange.

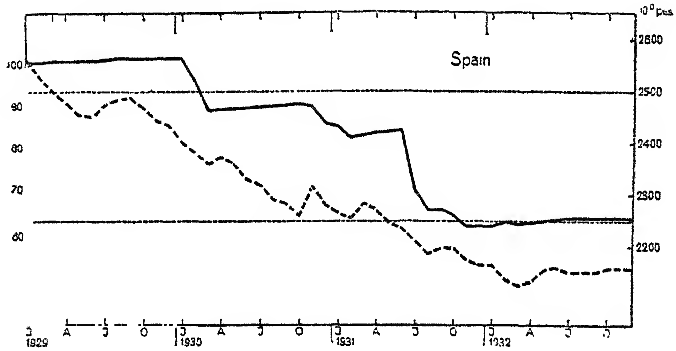


Diagram 9(5)

Relative rates of exchange and changes in gold stocks; monthly figures (continued).

It must be emphatically pointed out that all this does not mean to say that the rate of exchange is not a good regulator of home activity; that is quite another matter.

Further investigation shows at the same time that, when the rate of exchange is a bad regulator of equilibrium in the balance of payments, the wage rate is too. Moreover, it will be expected of such a country that, when in consequence of an improvement of trade conditions abroad the value of exports rises, the value of imports will rise to about the same extent, so that the equilibrium in the balance of payments will remain undisturbed — assuming

that the other factors remain unchanged —; the import or export surplus will undergo no change.

When, in the balance of payments of such a country, there are items for one-sided payments (payments against which there are no benefits), such as interest and redemption on unproductive loans, or reparation payments, then the increase, or the decrease, of these amounts will have great influence on the equilibrium of the balance of payments (in the narrower sense). For these amounts must be raised independently of the rate of exchange; the 'line of the payments' will, therefore, fall or rise just as much as the decrease or increase of these amounts does, and it is easy to see in fig. 10, that through this, the equilibrium, if it exists, is broken, or, if it does not exist, can be restored. If, on the other hand, the levying of such payments cannot be avoided, and an attempt should be made to stimulate exports by adapting the rate of exchange, then it would appear that this is impossible; or, when, as in case B, the import line and the export line run almost parallel, that a very considerable fall in the rate of exchange would be necessary. Similar considerations would hold good when an attempt is made to achieve an increased balance of exports, not by adapting the rate of exchange but by adapting wages. It will be all the more difficult to establish

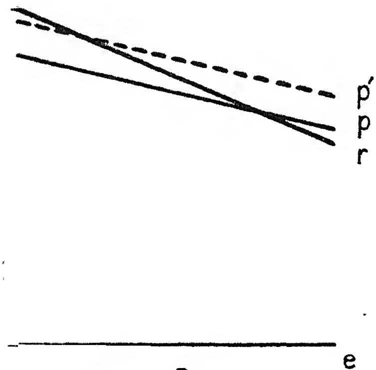


Diagram 10 B

a new equilibrium, if the export line drawn in fig. 8 above is not a straight line but a curve with a maximum. There is a great probability that such is really the case. A shifting of the line of payments upwards can, even in case B already, result in there being no new equilibrium at all — with whatever rate of exchange or level of wages — (see fig. 11). We shall refer again to this question in chapter X.

Thus we have seen that the condition for equilibrium in the balance of payments cannot always be formulated as a condition which the rate of exchange must satisfy. In various circumstances — always in the long run, and sometimes for a somewhat shorter period — the equilibrium in the balance of payments (in the narrower sense) is something which is brought about apart from the rate of exchange. These matters can be explained more clearly by reminding the reader of the connection between internal monetary equilibrium and equilibrium in the balance of payments. We will start with a very simple case; we assume that the balance of payments of a country only consists of the balance of trade plus, in so far as it is necessary, gold movements. We further assume that imports consist only of raw materials and semi-finished articles for production. Then the national income *(Y)* is equal to the value of production

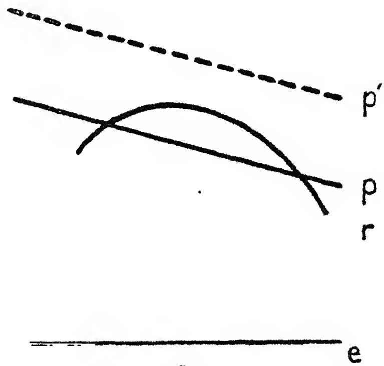


Diagram 11

(U), less the value of imports (U^i) and depreciation (N). In an algebraic formula:

$$Y = U - U^i - N \qquad (1)$$

The value of production (U) is further equal to the sum of:

the value of the goods destined for export (U^e)
" " " " " " for home consumption (C)
" " " " " " for home investment,

which can be subdivided into: goods for the replacement of worn-out and obsolete parts of the production apparatus (I^v) and for the growth of this apparatus (I^g); in a formula:

$$U = U^e + C + I^v + I^g \qquad (2)$$

Finally, the total home expenditure to be financed from income (U') is spent on articles of consumption (C) and on investments for the extension of the production apparatus (I^g), and, therefore, equal to the sum of these last two amounts:

$$U' = C + I^g \qquad (3)$$

If we now assume that:

(i) investments for replacement (I^v) are just equal to the amounts set aside for depreciation (N), and

(ii) expenditure to be financed from the income (U') is equal to that income, we get:

$$I^v = N, \qquad (4)$$

from which follows:

$$Y = U^e + C + I^v + I^g - U^i - N = U^e + C + I^g - U^i$$
and
$$U' = C + I^g = U^e + C + I^g - U^i \qquad (5)$$

Hence,
$$U^e = U^i. \qquad (6)$$

Suppositions (i) and (ii) mean that there is monetary equilibrium, as it is called nowadays: expenditure on the various goods and services produced is exactly equal to the value of those goods and is, consequently, just sufficient to buy them. Our last equation, which was a consequence of it (under the simplified circumstances from which we now started), means that there is equilibrium in the balance of payments. So this last equilibrium does exist, independent of the rate of exchange and any other data whatever, if and in so far as there is monetary equilibrium.

This conclusion can also be arrived at in a number of more complicated cases. Take for instance the case in which in the balance of payments the item export of capital (K^e) occurs, apart from the items of the balance of trade, consisting of subscriptions by private savers to foreign issues, or of the purchase of foreign securities by private persons. In that case there will be only the following alterations in the above formulæ: equation 3 becomes:

$$U' = C + I^g + K^e, \qquad (3')$$

while consequently equation 6 now becomes:

$$U^e = U^i + K^e \qquad (6')$$

Again this means that the balance of payments is in equilibrium. The same conclusion is also arrived at if by K^e is meant a tax, levied by the state on behalf of reparation payments abroad. Also, if a portion of the income consists of interest from foreign investments or the yield of other invisible exports, the conclusion remains the same.

There are, however, circumstances in which the connection between monetary equilibrium and equilibrium in the balance of payments is broken. As a first example, we suppose that there has been a conversion of assets which are expressed in home currency — for instance

banknotes — into foreign currency or securities. A purchase of such foreign securities then takes place, which does not occur out of the income, that is to say, nothing changes in equation 3, whereas one term is added to the balance of payments. It is evident that from the presence of monetary equilibrium it does not now follow that there is equilibium in the balance of payments. This case — if it occurs for a long time at a stretch — is typical of what happens if confidence in one's own currency is shaken. It matters less whether the conversion already mentioned of home securities into foreign ones is made by foreigners, or not; and just as little does it matter what kind of assets are converted here.

A second example in which there is no correspondence between monetary equilibrium and the equilibrium in the balance of payments, is the following. We assume that there is equilibrium in the balance of payments, as expressed by equation 6. This is not in conflict with the consumption of stocks financed by credit creation, occurring in wartime, for instance. In our equation, the using up of stocks means that, for instance, the production of articles of consumption (C) is smaller than the consumption of such articles (C'), which we represented in the previous equation by the same letter (C). The financing of a consumption C', greater than C, from created credit M means that the expenditure U' is greater than income Y: there is no monetary equilibrium. If only $M = C' - C$, however, that need have no influence on the balance of payments.

What is to be learned from these examples about the maintenance of equilibrium in the balance of payments? That in normal circumstances this is identical with the maintenance of monetary equilibrium; which means the same as the carrying out of a correct trade cycle policy.

The need of the latter is only further emphasised by this. But at the same time we have seen that maintaining monetary equilibrium offers no guarantee for equilibrium in the balance of payments, if, for a long time at a stretch, conversion of assets from one currency into another takes place. But there will also be little inducement to do so, if a good and internationally coordinated trade cycle policy is carried out, that is to say, if, in the leading countries, a policy of expenditure is aimed at, adequate to maintain a steady and high level of employment. These are subjects which we shall go into further in the second part of this book. The influence of the rate of exchange on the equilibrium of the balance of payments must be seen as an indirect one. If, and in so far as, the rate of exchange has an influence on monetary equilibrium, and if, and in so far as, the rate of exchange affects the conversion of wealth from one currency into another, it is also of importance for the equilibrium in the balance of payments. In a partially immobile world, as we have seen, the rate of exchange has an influence on the level of home activity. If this level is so low that part of the population uses up its capital to maintain a standard of living considered as necessary, then the monetary equilibrium is broken and with it the equilibrium in the balance of payments. The rate of exchange is then a regulator of that equilibrium, though it is an indirect one. Then it must be such that the activity is sufficient to make the using up of capital unnecessary. The rate of exchange can further, especially through a rather rapid and one-sided movement, have an influence on the confidence in the currency, and so contribute towards the conversion of wealth into other currencies. By restricting this movement, it will be possible here, too, to restore equilibrium in the balance of payments.

But there will often be other factors exerting an influence, which, apart from the rate of exchange, can be of importance for the regulation of the equilibrium. Such factors may be the management of the state finances and the monetary system. In this connection, the experiences of Germany in 1923 should be remembered. The heavy social expenditure of the government led to their taking recourse to the banknote-press, to satisfy their need of cash. This meant a serious disturbance of the monetary equilibrium, which for the balance of payments could not be but fatal. Another example, also of great importance in the German situation just discussed, is that of reparation payments. These, too, can be a motive for making use of the issue of banknotes, thus disturbing monetary equilibrium; though this, of course, is not necessary at all.

Factors such as political uncertainty, or the dislike of certain measures of the government, can lead to a hoarding of a part of the incomes, and so also to a disturbance of monetary equilibrium, and that in the opposite direction; now there will threaten to be a surplus of exports. The situation in the United States between 1933–1938 showed this.

Until now we have chiefly discussed slow changes in the level of exchange rates, or changes which occur but once, and their importance for the maintenance of equilibrium in the balance of payments (in the narrower sense). In practice, it is possible to achieve a fair state of stability in a rate of exchange, though it may be a floating one, after adapting it to a new situation: the operations of an equalization fund serve this purpose. If the rate of exchange is not kept under control in this way, then besides the consequences discussed above, of the change in exchange rates, still further consequences come into play, which

might be indicated as 'speculative'. The considerations which influence the speculative purchases of currency can be of two sorts. If they are based on the absolute level which has already been reached, which is then compared with a level considered normal or probable, the speculative purchase is a force working in the direction of equilibrium. In 1924 it was made known in Denmark and Norway that it was intended, in the long run, to restore the old parity. Speculators believed this and bought so many crowns that the level was reached much sooner than was intended, as we have already pointed out. The speculative purchases of German marks by foreigners were, in the beginning of the German period of inflation, based on the expectation that a more normal, higher level of the mark was again to be expected. These purchases did also work towards a temporary recovery. But later on there were purchases, from the German side too, which were based on the movement in the rates of exchange: it was presumed that the fall which had once begun would continue, independent of the question whether there was a sort of normal level. This 'speculation of the second type' is very dangerous. It leads to a strengthening of the movement, also when this is directed away from equilibrium, and sometimes in fact makes the establishing of equilibrium impossible. Its dangerous working is also known on the stock exchange; the prices of speculative stocks should be thought of, for example, in the United States about 1929. In the case of the German mark it also did its work, and contributed towards the collapse. If it crops up, the most vigorous steps must be taken against it. But in many cases prevention is the only cure, and prevention can only mean the maintenance of monetary equilibrium.

If we put the contents of this chapter shortly, we may say

that with a partial state of immobility of economic life the rate of exchange can have an influence on the condition of equilibrium in the balance of payments (in the narrower sense), but it need not have this at all. That is why it cannot always be used as a regulator. An investigation into the facts will be necessary in every case that occurs. Apart from its own merits, however, the maintenance of home monetary equilibrium is desirable, also for the equilibrium in the balance of payments.

SECOND PART

REGULATION OF INTERNATIONAL ECONOMIC RELATIONS

Chapter VI

AIMS OF A REGULATION OF INTERNATIONAL ECONOMIC RELATIONS

In the preceding five chapters we have endeavoured to make clear the essence of international economic relations. We will now, in the five chapters following, deal with the question whether, and if so, how a certain regulation of these relations should be aimed at. In doing so, we will take existing conditions as our starting-point; not the conditions of wartime, but those which will, after a certain period of transition, develop into a more normal situation. Hence we do not mean to deal with those temporary measures which will prove to be necessary in order to alleviate the greatest distress or in connection with military operations; it is the more final arrangements that will form our subject-matter.

If the conditions that prevailed in the international economic field between 1918 and 1939 are reviewed, the conclusion is evident: the chaotic development of those years can in many respects not be put up with again. It was far too much incidentally that the difficulties arising after the First Great War were faced; a policy of tinkering and makeshift. Therefore, in view of the presumably far greater difficulties which will arise after the Second World War, recourse should a fortiori be had to a programme that has been well thought out and for whose execution people are ready to use force. A programme presupposes an aim; it is this aim about which we will speak in this chapter. It is not difficult to find a formula for it, which as a formula will satisfy anybody: as our aim we wish to put the

promotion of 'general interest'. It is more difficult, however, to make this formula more concrete. We already wrote about these difficulties elsewhere[1], therefore we shall here only give a summary of the conclusions reached there. These were, for instance:

1. The idea of 'general interest' must remain vague as long as no method has been found to weigh a decline in the satisfaction of one person's wants against an advance in those of another.

2. The satisfaction of anybody's wants is dependent on greatly varying aspects of human life: the possession of material goods, health, a certain measure of liberty, opportunities of employment and a certain measure of certainty in life; promotion of one aspect often causes a neglect or opposition of the other.

3. People often do not know their own happiness: they have incorrect or too limited conceptions about it.

4. People differ greatly in natural ability, accomplishments and desires: tastes and requirements differ.

Viewed internationally this becomes even more difficult, because between the various nations, too, there are great differences in their views of life, ability, wealth and history, which appear, for example, from their widely different aspirations and forms of government (compare Germany, Japan and Russia with the western nations on the one hand and the oriental countries on the other); and in the sovereign power of nations, hitherto accepted, in many matters which also touch their neighbours and other countries in the world.

These difficulties may result in a permanent difference of opinion as to the aims of economic policy and are the cause that any programme will show subjective elements

[1] De les van dertig jaar, chapter 12.

as long as these difficulties have not been solved. For instance, certain suppositions have to be made about the relative importance of the desires of one man compared with those of another, and one must presume to give an opinion on what is good for others, even if they do not see it themselves.

The complete solution of the problem of the organization of the international community, however, is not the task of the economist. The latter has only to occupy a discreet place beside the expert on matters of government, other experts of organization, the psychologist and the pedagogue, the sociologist and many technical experts. As for the problems touching himself, he will have to be on his guard against inexpert solutions; in the past he has been listened to far too little: witness what happened to Keynes after 1919; but it should not be thought either that everything will come in order once the economic problems have been solved. Even more than after 1918, much has been destroyed this time that belongs to the competency of others. Moreover, new branches of science have since revealed to us aspects of the community which must on no account be neglected. One group of surgeons, at any rate, will have to be more modest than in 1919: the politicians. For the very good, real politicians this holds good to a lesser degree than for those among them who, properly speaking, are nothing but representatives of group-interests. It is to be hoped that especially the solution of the most difficult problem, the finding of the correct treatment of the conquered peoples, will not be left to the feelings of politicians only, but will also be based on the opinions of a great number of sociologically-schooled scientific men.

In this publication only the economic aspect will be elucidated to some extent. In our opinion, the aims of a

regulation of international relations may, in this respect, be formulated as follows, according to the further investigations mentioned above:

(a) a production as large as is possible;
(b) a production of the greatest possible stability;
(c) a distribution, as fair as is possible, among
1. persons and classes, and 2. peoples;
(d) a number of conflicts as low as possible, both within the borders of each country separately and among the various nations;
(e) a liberty as great as is possible for the parts, i.e. for individuals, enterprises and states.

It should be borne in mind, however, that these aims are not entirely independent of each other and that it is possible, therefore, that the promotion of one of these aims is prejudicial to another. Hence the question remains to be answered how these aims, as far as they are in conflict with each other, are to be weighed one against the other. As long as measurements are still impossible in this respect, it will be necessary, as was pointed out in another connection, to leave this weighing-off largely to the subjective judgment of the economic-politician. The aims under (d) and (e) have a more passive meaning: especially with regard to the question of liberty it should first be investigated, in how far the other aims leave the possibility of a certain freedom of the parts. Opposite the possibility of conflicts among the various aims there is the fact that the attainment of one object also brings the other object nearer. Thus the number of conflicts will already diminish, when production has increased and reached greater stability and distribution has become more equitable than before.

Most of these aims have an internal aspect for each

country separately as well as an international aspect; the present work only deals with the latter. This means, as we shall see, that for some points, especially point (a) but also (b) and (c) even the main points will not receive treatment here.

The principal measures by which the aims, mentioned as desirable, can be attained, are, as regards the points (a) and (b), included in a good trade cycle policy in the widest sense of the word. The aim of this policy might be defined as the 'living within one's means' for the entire social system, and then in this sense that — apart from the normal increase of the circulation of money over longer periods — not only not more than the income is spent, but also and especially not less than the income. For the non-spending of the income brings about the depression. 'Spending' in this connection is also using the money for the expansion of plant. After a detailed analysis of the mechanism of economic movements and of the experiences gained with different measures in the field of economic policy, especially since 1929, I have elsewhere[1] come to the conclusion that it is possible to attain a practically full employment of the productive apparatus without the disturbing effects of serious depressions if certain conditions have been fulfilled. The measures necessary for the attainment of this objective are not so far-reaching that every gesture of private entrepreneurs is to be restrained, as in a situation of war-economy or as is the case in Russia. Apart from some exceptional situations which will be dealt with later, it suffices that the authorities should follow a

[1] Economische Bewegingsleer, especially the supplement about „Beïnvloeding der economische bewegingen", Noordholl. Uitgeversmij, Amsterdam 1942-1945.

policy of 'compensatory expenditures'. This policy means that in times of a depression in private business-life a greater number of government orders is given than in times of great activity in the private sector. For this purpose the government must have a reserve of unexecuted public works, of which the preliminary work has been completed already and from which they can draw 'at call'. Also other than only public works can be used, as for instance the ordinary official activities, and the many cultural and social objects by which social life can be raised to a higher level. We are thinking of research-work, the creation of possibilities for travelling and recreation for those big groups of the population whose income is insufficient for these things and many other projects of the kind.

The execution of these projects should not be financed from increased taxation. It is better not to raise the rates of taxation in times of depression, — perhaps even better to reduce them, — because an increase would check enterprise still further. The financing should be done by means of loans and by the creation of new credit, as long as there is no cyclic reserve to draw from. The creation of the latter should be aimed at in boom periods, when the revenues ought to exceed the expenditure of the government. In boom periods it is not desirable to redeem on a larger scale, because in this way large sums would come in the hands of individuals, which might lead too much to new investments. The reserves made in boom periods should not be invested in the ordinary way, but kept liquid, for example as a special account with the Central Bank. For also an investment in securities would mean that money would come at the disposal of the public, which at that moment had better remain inactive.

It is probable that the raising of loans in slump periods

does not attract all the parts of the incomes that have remained unspent. As, however, the aim of cyclic policy in slump periods must be to let the incomes flow on, and thus maintain the level of an approximately full employment, it will be possible by the creation of more new money than is compatible with the structural growth of the social system, to provide a certain compensation. During the slump itself this will not involve any dangers. It will, however, when the recovery announces itself and the amounts hoarded before come into activity, together with the newly created means. If the recovery should develop too rapidly, an economic overstrain might be the result, with wrong investments and a repercussion in its wake. This is the moment when the government may have to intervene to a larger degree than will be necessary in other cases. The means at their disposal are: rationing of credit, of imported raw materials and machinery, perhaps even of raw materials and machinery produced in the country itself, and price-control. When, however, the depression has been mitigated by the measures described above, the revival is also less impetuous than was sometimes the case formerly. For the arrears in replacements, in stocks and in the requirements of consumers are less and only a very small rise in prices will take place, owing to which speculative purchases of raw materials will also be less intensive. Therefore the hope is justified that the circumstances indicated above as exceptional situations, will only seldom occur and that these more drastic measures rather have a preventive character.

The trade cycle policy here drawn in outline — and for the details of which we again refer to the publications mentioned — is, as we also observed before, tied to some conditions as to its practicability. The first and most

important condition is that industry in general shows an understanding for the sense of these measures; especially that it is realized that unhampered trade and industry are of themselves unable to prevent economic fluctuations and that it is therefore a natural duty of the government to see to it. In the U.S.A., between 1933 and 1938, this was insufficiently realized and the high government expenditure led to a strong aloofness in the expenditure of private people, both as regards investments and articles of consumption. This aloofness had a strong adverse influence on industrial activity. If these views should not be reconsidered, the possibilities to attain a reasonable measure of employment and stability in an industrial life that is still free in many other respects, are so slight that the only solution lies in a far more drastic interference of the government: in a sort of war-economy or socialisation on a large scale. Thus, however, initiatives of great value to the community would presumably also be lost, and it is to be hoped, therefore, that industrialists and authorities will appreciate each other's contribution towards the establishment of more stable and better economic conditions and will act accordingly. As far as the industrialists in the Netherlands are concerned, and as it seems equally in Great Britain, I think I am entitled to state that a distinct change in opinions has taken place which gives rise to a feeling of optimism.

A second condition for the success of the economic policy outlined above is that internationally there should arise sufficient cooperation in this respect, so that the national trade cycle policies of the big countries approximately run parallel. If Great Britain should endeavour to follow such a policy — and government utterances give rise to hope in this respect — it must not be thwarted by the

U.S.A., Russia, France or Germany. If these four big powers should work in approximately the same direction, the chance of success for each country separately would be greatly increased, without the necessity of an intricate international system of cooperation. It is to be hoped that especially the U.S.A. will realize their great responsibility in this respect. If there, as is feared by Myrdal, and notwithstanding the warnings of prominent economists such as Hansen and Stuart Chase, economic control should be insufficient in consequence of the attitude of powerful groups of employers, things may be spoilt for the world as a whole.

The measures which in my opinion will especially be necessary to attain the more equable distribution among the persons and classes of one nation as mentioned before under (c), belong to the domain of taxation and social legislation. Proposals in this connection have also been published elsewhere[1]. I am especially of opinion that wage policy offers only limited opportunities, and that large-scale socialisation has by-effects which do not or not yet make it attractive in the present epoch. A common characteristic of importance in the measures of economic policy suggested so far is, that they are chiefly problems which must be solved within the different countries. It is first and foremost of importance to the rest of the world what the big powers, the U.S.A., Great Britain and Russia will do in this respect. International relations are only of secondary importance in this connection, although they must answer certain requirements to which we shall revert later.

By their nature the aims mentioned under (c2), (d) and (e) are, however, to a larger degree questions of international

[1] Redelijke inkomens, 1945.

relations. Thus in chapter IX we hope to expound that a reduction of the differences in the standards of life can mainly be effected by capital export from wealthy to poor countries. A diminution of the number of international conflicts, as far as they are of an economic nature, should be aimed at — besides in the field just mentioned — by banishing arbitrary actions in the domain of commercial policy and technique of payment, tolerated in consequence of the complete sovereign power of nations. We shall revert to these matters in the chapters VIII and X.

The demands which the points (a) and (b) — mainly referring to the internal economic policy of the big countries — make upon international relations, find their origin in the disturbing influences, both on the absolute height and on the stability of production, emanating from international commercial and financial policy. Besides the stability of production in the big countries, they endangered to a much greater extent the stability of production in the small ones. For the small countries are dependent on foreign outlets for such a substantial part of their production that a slump in one of the big countries always brings along difficulties for the small ones. Therefore, the measures of trade cycle policy also have an international aspect for the small countries. Which does not mean to say that a small country should be entirely at the mercy of the waves of the world's economic situation. If it has a sufficient currency-reserve at its disposal, it can greatly mitigate by compensating government measures the consequences for the home market. It will also be able to do something by a suitable rate of exchange policy, if necessary. However, this is not the place to go more thoroughly into these questions, because they have to do with national economic defense rather than international cooperation.

Also for reasons of economic policy, therefore, a limitation of sovereign power is essential; the policy of trade and payments of every country will have to come up to certain requirements. It should be impossible for any one country suddenly to close its frontiers entirely or partly for the products of other countries. Moreover, the financial management should come up to certain demands of stability: great fluctuations in the rates of exchange or even the threat thereof, by inefficient management, should become impossible. A correct settlement of the problem of international war debts and of possible reparation payments will be imperative in this connection. Also these points will be dealt with extensively in the chapters IX and X.

After this brief survey of the principal measures of economic policy which we consider essential for the attainment of the aims mentioned, we shall now treat in detail of those among them which are of especial importance for international relations. The same division of subject matter will be followed as in the First Part of this book. So, before dealing with commercial policy, capital export and financial intercourse in the chapters VIII, IX and X, we will expound in chapter VII what is the significance of problems of population policy for the attainment of a better economic community, and why, for the present, we do not consider transfer of territory a correct means in economic policy. In chapter XI we shall discuss the necessity of an international centre for economic policy, while in chapter XII some observations will be made concerning the position of the Netherlands with regard to international economic cooperation.

CHAPTER VII

PROBLEMS OF TERRITORY AND POPULATION

In this chapter we will for a moment abstract our attention from the concrete military and political situation; especially from the fact that at the present moment the relations between the different nations are still so largely governed by the military aspirations of Germany, Japan and Italy. We will for a moment only consider the economic aspect of these relations, and then in broad outline and for future times; one might say, hoping that all this will one day be possible again. The world's economic problem can then be formulated as follows: in what way can the world's population be given the greatest possible prosperity, divided more equally among the nations?

The prosperity to be attained naturally depends on many diverging factors. Of great importance, as is generally known, are: technical development and the formation of capital; the latter problem will be dealt with more extensively in chapter IX. Of importance are also the possibilities of barter and the manner of distribution, which will likewise be dealt with later. On further consideration, however, one meets with two other factors, of which we shall treat in this chapter.

The first of these factors is that of the *size* and the *growth* of the population. Both exert an influence on prosperity. This influence is rather complicated, but something, at any rate, may be ascertained about it. Let us consider in the first place the influence of the *size* of the population that has so far been reached. In order to do this correctly

and abstract for the present from the influence exerted by the *growth* of the population, let us, in our minds, compare two situations: one of a thinner and one of a denser population. In many respects it is of little importance whether there are many or few of us. Every individual not only has a mouth, but also two hands; speaking in economic terms: he is not only a consumer, but also a producer (though it is true that in the course of his life he is a consumer before becoming a producer; we shall revert to this later on). In some respects a denser population may even be more prosperous: by well-organized cooperation some branches of industry can then work more efficiently. This will hold good especially for traffic, because the living closer together of the population makes mass-transport possible, which is not the case when the population is thinner.

Thus reasoning, we put it for a moment as if in this form of production only labour is required. Actually also capital is necessary. And there things are different. The supply of capital goods at our disposal is partly inherited from the past, and therefore partly independent of the size of the population now. Only the additions to this supply which are made every year, are dependent on the size of the population. Therefore a denser population is at a disadvantage in this respect.

This holds good even more strongly with regard to the soil, hence especially for agricultural and mineral production. The extent of soil and the natural resources contained in it are independent of the size of the population, and the denser the population, the less there is available per head. It is in a country like China that the adverse influence of a dense population appeals most strongly. Four acres per farm is only available there, whereas the most economic size would be 13 acres. The production of

cereals in China is only 1400 kilos per man-year as against 20,000 kilos in the U.S.A.

Also in the Netherlands the problem of land-hunger is known only too well!

A further investigation shows that this influence is of greater importance than the above-mentioned favourable influence of a dense population on the efficiency of some branches of industry such as traffic. Hence it follows that the size of the population has a negative influence on prosperity: the greater the population is, the smaller its prosperity will be, taking it that all other circumstances are equal[1].

We will now look at the influence of the *growth* of the population, i.e. of the fact that at a certain moment the population is increasing. On one hand it is customary to say that a growing population is probably more enterprising than one that, in consequence of a small number of births, is stationary or even decreasing. A growing population, it is said, is a sign of an energetic attitude towards life. This is correct for the person who

[1] Wagemann has brought together statistical material, by which he tries to prove that the relation between density of population and prosperity is indicated by a line alternately falling and rising. He called this the „Alternationsgesetz", which would involve that there is more than one relative maximum and more than one relative minimum in prosperity, and that a country in its development and with an increasing density of population alternately passes through phases of relative overpopulation and relative underpopulation. Germany, Italy and Japan would then find themselves in phases of relative overpopulation. The suggestion is interesting and certainly deserves closer attention. For the present our own investigations make us believe that this alternation is not certain, but that there *is* a broad interval of population densities, inside which the influence of these densities on prosperity is comparatively slight. For the very slight densities, however, the negative influence is quite distinct.

deliberately aims at a large family. But most big families are found among those strata of the population, where it can only partially be said to be a question of deliberate choice. And then the argument of enterprise in such families seems to us to be rather doubtful. It is presumably a matter of quite different forces.

On the other hand the fact of a growing population will probably stimulate production to a certain extent. From the view-point of the separate family, many things are needed in a growing and large family, so they will have to work hard. Considered from the point of view of the social system as a whole, there will be a great demand for new houses and other lasting objects for use and investment in a rapidly growing community. This is of all the more importance, as was already pointed out above, because the new arrivals start their lives with consuming and only begin to supply their productive contributions after a good number of years.

So there is no denying this stimulus for production. But it should not be forgotten that it results from the very fact that, calculated as to the possibilities of consumption per head, prosperity declines in a growing family, i.e. from the fact itself, discussed above, that a large population means a smaller prosperity when all other conditions are the same. And it is highly doubtful whether this stimulus is able to reverse this trend.

On the strength of the above arguments — of which the figures about the influence of the size of the population on agricultural production form the chief part — I do think that also the prosperity of the world's population could grow more rapidly, if the population of a number of countries, such as for example China, India and Japan, but also Holland, should grow less rapidly or even decline.

Apart from this it is equally clear that prosperity would be spread more equally, if the possession of natural resources were spread more equally. Chapter I already dealt with the inequality of this spreading; we saw that it is especially the Anglo-Saxon races that possess a relatively large share of the natural resources.

The two problems that have been broached: that of population and of the spreading of natural resources, are international in character. It cannot leave the rest of the world cold, if at present Italy and Japan, later perhaps China and India, in consequence of over-population have come to the formulation of demands that have as their object the property of races that are blessed with more worldly goods. Even if it should be thought that for example Germany has abused the argument of over-population to mask other intentions with it, this can hardly be maintained in the case of Japan; that country is indeed overpopulated. And once China and India have undergone a further evolution in political respects, it could hardly be resented if the thoughts of these countries should follow the same lines; it can only be hoped that by that time other methods will be followed for putting, considering and meeting such claims. Both nationally and internationally, therefore, the problem of population control is sure to present itself, and sooner or later we shall have to come to an international policy in this connection. By closing one's eyes for it, one fools oneself and perhaps misses opportunities for a happy solution of threatening difficulties, which will no longer be possible once it is too late. Thus the demand put to Japan that this country must withdraw within her 1897 borders, will in point of fact appear to come down to a camouflaged demand of population policy — and a very heavy one at that — in the name of the United Nations.

Unfortunately the discussion about this question is rather heavily weighted with dogmatic conceptions. These are closely related with the moral aspect of birth control, an aspect of which we think by no means lightly. In the penetrating discussion of these problems which, we hope, will start again after some time, all aspects, and certainly the moral one as well, should come up for their share of attention. The only condition which, in our opinion, this discussion should at any rate fulfil is that it be unprejudiced and with appreciation for each other's standpoint. Further it stands to reason that those who have insurmountable objections to birth control should thoroughly realize, what the demand put to Japan actually involves and what will be the logical results of their standpoint for the future level of prosperity.

The problem of the distribution of natural resources is as thorny. On the one hand a certain right of those who have discovered certain territories rich in natural resources, cannot be denied. But this right cannot go very far. Also the consideration that the present possessors of many of the rich territories make a more efficient use of them than possible other possessors, is only a very partial justification of the inequality of the division. It has been tried to parry the call for 'admission to the raw materials' on the part of the 'have-nots' among the countries by the statement that the goods produced in the countries which are rich in raw materials are placed at everybody's disposal at the same price, so that in practice there would be no difference between the possessors and the non-possessors. This argument is very weak, however. For the very production of these raw materials is a source of prosperity, which is desirable in itself and to which every nation has a certain title.

In the long run we cannot imagine a stable world order unless the two great problems mentioned have been given a solution that has more sense than only the maintenance of the status quo.

Just now it would be inopportune to open the discussion about these problems. They are crossed too much as well as obscured at the moment by military and mental aspirations. Japan endeavoured to accompany every economic penetration by setting up power centres. Germany and Italy were driven too much by purely military aspirations, which also on account of the mental forces behind them, were unacceptable to western culture. The resulting wounds must have healed and the basis been found again for actual cooperation in spiritual matters, before the economic problem can come up for discussion, and then unobscured. This will take a long time; let us hope that that time will be used well. At any rate that time may be used to prepare the solution of the two so very difficult problems mentioned. One should not shut one's eyes to them.

Another, more economic aspect of the problem of transfer of territory is touched upon by the recent proposals to add in one form or another part of the German territory to the Netherlands. Some speak of annexation, others of mandated territory; one hears it vindicated that the German population should have to leave that area, whereas others are of opinion that this should not be done. Although this problem does not quite belong to the subject in hand, the temptation to say a few words about it, now that we are in the immediate neighbourhood of it, is too great. We shall restrict ourselves to two aspects of the economic side of the question, though it is evident that the political side is at

least as important[1]. The arguments of the proposers are also largely of an economic nature and are twofold: in the first place they see in such an extension of territory a compensation of the damage to cultivated land which we have suffered in consequence of flooding, in the second place they expect a facilitation of possible reparation payments or achievements. It is pointed out that in this way the transfer problem can be avoided.
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When discussing these arguments discrimination should be made between an extension of territory inclusive of the population now living there and also exclusive. When also the population is transferred to within Dutch borders, the extension only then means an alleviation of our land hunger if the population density in the area to be annexed, calculated per hectare of cultivated soil, is considerably less than with us. We doubt whether valuable areas can be indicated for which this is the case. Should it not be desired to add the population to the Dutch, then they would have to be transferred; it is evident that, even apart from purely humanitarian objections, enormous dislocations would be brought about. Especially in the remaining part of Germany prosperity would be diminished even more strongly, which woold cause economic difficulties on a large scale — also for our exports.

[1] Cf., however, appendix III. Moreover, it should not be forgotten that the following text was written already in 1944. Since then, several other aspects have been taken up for discussion.

As to the facilitation of the reparations problem: in a literal sense it is true that no transfer would be necessary; but that is far less important than is generally believed. In chapter V we already pointed out that also for each part of a currency-area — in this case for the annexed German district — payments and receipts must be equal. Reparation payments, also if they could be made in Dutch florins consequently, would still require a strong increase of exports by this territory, for which the same difficulties count as those which are usually — though somewhat unhappily — indicated as transfer difficulties (see also chapter X).

In whichever way it is desired to tackle the reparation problem, either by payments in money or in kind, the difficulty will always remain that then a strong discrimination will have to be applied within our territory: either taxation in the annexed districts will have to be higher or they will be oppressed by supplies in kind. It would seem to us that the existence of such a discrimination within one and the same territory will cause more difficulties than if there should be question of two different countries.

With these arguments the political side of the problem has naturally not received treatment; we shall not enter into the advantages and drawbacks connected with it. However, one should guard against too optimistic a view of the economic effect.

Chapter VIII

PROSPECTS AND REGULATION OF INTERNATIONAL TRADE

We shall now start to discuss at closer range the measures in the international economic field that can be and should be taken already now, considering — as announced — in the first place the problems of international commercial policy. We shall preface our observations with some remarks about the prospects of international trade.

In the first few years after the war this trade will certainly not be limited on the part of the requirements: there is a very great need of completion of every imaginable kind of goods-supply in large parts of the world. Although that is not quite the same, it may also be put that on the part of demand — i.e. requirements backed by purchasing power — no limitation will be imposed. In spite of the disposition to economy which will arise on all hands — and may it not go so far that it becomes unwise — we expect the actual demand for goods to be very high, too. The limitation which will be felt at first is more likely to come from the supply. In the countries where the war has raged, much productive capacity will have been lost and it will be some time before countries like Germany, Russia, the Netherlands and so many others will be able to export again. The reconstruction of plant, of livestock, of the stocks of semi-manufactures and raw materials will only gradually proceed, and only after a number of years will the supply of finished goods be comparable again to what it was in 1938. Probably, however, the shipping position will not cause the same concern as in 1919.

Though, consequently, in the period of reconstruction there will be little need for concern about outlets, the problem of exports will, in the opinion of many, emerge again in proportion as the reconstruction gets to the less urgently required goods and more normal conditions begin to prevail again. It is not only in neutral countries and the U.S.A. that all kinds of measures are already being planned and discussed to stimulate exports, i.e. preparations are being made for a new race in competitive measures. Countries reckoning with high obligations for the future — such as, for instance, Great Britain — are not only planning for increased exports, but also for reduced imports. Thus a repetition of the conditions after 1930 is threatening.

This state of mind is typical of the mentality which develops during a slump: every seller is feared for his competitor's supply and efforts are made to keep him out, but it is forgotten that, if he sells more, he can also buy more. This slump mentality is exactly the opposite of what we saw in war time, when competition on the part of demand entirely governed the minds: everybody desired the goods and not the money. Also for the period of reconstruction this latter mentality will have to be taken into account — unless the financial policy should turn out to be too stringent. There is some sense in a slump mentality during a deep depression in so far as there will be a general inclination to spend less than is received. For more normal times, however, such a disposition is, economically speaking, not necessary at all and even to be considered quite harmful.

An example of the exaggerated pessimistic commentaries, caused by a slump mentality, as have been given about the rise of new competitors, is that of Japanese competition after 1929. Because this, particularly for the

gold bloc countries, fell actually in a period of depression, the concern was comprehensible in this case; but the commentaries generally overlooked the fact that Japan in that period not only exported much more, but also imported at least as much more. The following figures will prove this:

IMPORTS AND EXPORTS (WITHOUT GOLD) OF JAPAN, TO COUNTRIES, IN MILLIONS OF YEN:

	Imports		Exports	
	1929	1937	1929	1937
China	210	393	347	395
Kwan-tung	166	45	124	396
India	288	454	198	318
Indonesia	77	153	87	200
Great Britain	153	106	63	168
Germany	157	176	13	43
U.S.A.	654	1270	914	639
Canada	69	105	27	20
Australia	133	165	44	72
Totals (incl. all others)	2216	3783	2149	3175

It is true that Indonesia could not benefit as much by these increased imports as the increased exports from Japan amounted to, at least not directly. In how far it has benefited indirectly by the increased Japanese activity, in consequence of the greater purchasing power of those countries whose export balance to Japan increased, can only be ascertained after further investigation. Moreover, it is quite possible that our sticking to the gold value of the Dutch florin has also tricked us. Last of all it is possible that the goods required by Japan, were not produced by us. Also in its later development Japan will especially need raw materials — for labour it has in abundance —; so

anyone who also wishes to profit by the industrial development of that country — and of other countries — will be wise to offer the raw materials required for it.

Besides the reasons already stated, why — incorrectly, we think — too pessimistic commentaries have been connected with Japanese competition, there is another fact: Japanese expansion was forced in so far that it was based on an inflation which that country will be unable to maintain. This inflation led to prices and wages in money still appearing acceptable to employers and workmen, but the actual remuneration embodied in them, dwindled further and further. Once the adaptation of the cost factors to the increased prices will be complete, part of the industry will be unable to sell any longer at these prices. The real rate of wages fell from 1932 to 1938 by 26 %; export prices, expressed in yen, rose it is true by 36 %, but wholesale prices in general by 56 %. Hence it becomes clear that in this case we had partly to do with an economic development, caused in the first place by the armament inflation, that could not last.

A different mentality from the slump mentality referred to above will be needed for the regulation of international trade, if we are not to fall again into the same restrictions of economic intercourse, which after 1930 caused so much harm and which ultimately were to lead to ruin. Indeed, this does not only hold good for foreign trade; it is a general rule. If it should become fashionable to spend less than one receives, consequently always to adopt a waiting attitude, a renewed stagnation in the economic circulation process will surely result and society cannot suffer this. If free industry, assisted by additional state expenditure in slump years, does not itself see to the necessary expansion and by this maintains employment, only a socialized production can

yield us full employment. Socialization in the present epoch would, however, be attended by all kinds of losses of freedom and initiative, owing to which, in our opinion, this would not benefit society as a whole. If this is correct, it is to be hoped that free industry will have sufficient energy to tackle enough new projects, even if the chances of profit should be somewhat less than formerly in periods of improving economic conditions. For these smaller chances of profit are, in a society with a more stable economic development, offset by a greater certainty, owing to which the risk premium can also be lower. It is further to be hoped that industry will have sufficient understanding for government initiatives meant to extend production; for, as we explained elsewhere, these initiatives are perfectly logical and indispensable in a good economic policy.

A regulation of international trade relations should further be based on the following considerations. In the first place it may be taken that, much more so than between 1919 and 1939, it will prove to be possible approximately to reach a condition of full employment, in consequence of which the slump mentality referred to above is unnecessary. In the second place it must be borne in mind that under such circumstances — according to what we expounded in chapter II — not only no great objections can be raised against free trade, but that the latter will even lead to a higher prosperity than any system of hampering free intercourse, and that in this case an equilibrium between countries with a high and those with a low standard of living is quite possible. In the third place the limits should be taken into account that are put to the ability of any country to pay interest and redemption on war debts and reparation payments, a problem discussed in chapter V

and to which we shall revert again in chapter X. The principle for the regulation of trade relations which follows from the above considerations is that an *approach to free trade conditions* is preferable.

If this procedure is followed, the perspectives for the future can even be called favourable. This is, if not proved, at any rate illustrated by the calculations of Colin Clark. This British statistician, basing himself on an extremely extensive material of figures and mainly justified methods of working, has estimated the extent of international trade in 1960[1]. In short, his method comes down to this. Starting point are the evaluations of the size of the future population of the different geographical regions of the earth. Next it is assumed, on the ground of what was ascertained in the past, that the productivity of labour in all non-agrarian branches of industry will keep on developing at the same rate as before. For it has been proved that this rate was not even permanently interrupted by the First World War. The productivity of labour in agriculture, in terms of industrial products, is dependent on the density of occupation of the soil; the greater the agrarian population density, the smaller productivity will be. Moreover, it depends on the price of agricultural products, expressed in those of industrial products. Clark now assumes that the distribution of the population over agriculture and the other branches of industry is regulated by the relative height of the incomes which can be drawn from these branches; accordingly, of the productivity of labour. From this distribution, which is consequently dependent on the price mentioned, the supply of agricultural produce can be deduced, while from the height of incomes their spending and hence the demand follows. Together they determine the price

[1] Colin Clark, The Economics of 1960, London 1942.

and at the same time the quantity produced and consumed in each country. If the production in any country exceeds its consumption, the surplus will be exported in exchange for industrial and other products from countries which are short of agricultural products. On the basis of this analysis the writer comes to estimated figures[1] for the world's trade in agricultural produce of the year 1960, from which we quote the following table:

WORLD TRADE IN AGRICULTURAL PRODUCE, IN MILLIARDS OF $ WITH THE PURCHASING POWER OF 1925-1934

Countries of Export	Exports		Countries of Import	Imports	
	1935/38	1960		1935/38	1960
Africa	0,63	5.15	Russia	—0.01	4.34
Central and South America (without Argent. a. Urug.)	1.29	3.67	U.S.A.	0.94	3.61
			Japan	0.25	3.12
			Gr. Britain	1.95	2.29
Balkan countries	0.09	1.76	Germany	0.75	1.17
India	0.51	1.38	Poland	0.01	0.74
Argent. and Urug.	0.62	0.72	China	—0.17	0.56
Western Asia, S. E. Asia, Java, Other Ind. islands	0.80		Netherlands	0.04	0.07
Western Asia		0.90	France	0.57	0.00
S. E. Asia		0.51			
Java		0.33			
Other Ind. islands		0.83			
Total, incl. all others	4.90	16.10	Total, incl. all others	4.80	16.50

It will be seen that apart from of a strong expansion there are considerable changes in international trade between 1935/38 and 1960, if the tendencies assumed

[1] The figures are net for the group of agricultural products as a whole, i.e. the sum of surpluses of imports and exports of the separate products.

continue. They are chiefly the result of the expansion of industry in Japan, China, Russia and the U.S.A. Thus the high import figures of these countries can be explained. It stands to reason that these figures should not be taken seriously in every detail; all sorts of unexpected disturbances may occur. The disturbance of the Second World War is not likely to have been correctly anticipated bij Clark, who concluded his computations in 1941. The figures show, however, — and that is their importance for the subject in hand — in what way an equilibrium is possible between countries with a high and those with a low standard of living, notwithstanding the increasing productivity of labour both in the rich and in the poor countries, and in spite of the greatly increasing production in Eastern countries. As a by-result it is also interesting, e.g. for the Netherlands, that the price level of agricultural products as compared with that of industrial products will rise considerably and in 1960 will lie about 85 % above the level of 1935/8. Such calculations show us, even if they should have to be revised materially, that a favourable development of international production and trade is possible, and they also and especially show us where, i.e. in which countries and in which branches of industry, the lights in the development are to be sought, which also exist by the side of the shade to which everyone is so susceptible, and even in a preponderating degree. Consequently, even if there is reason to fear that an economic life left entirely to its own devices will again lead to crises and depressions — and we share this view — from the computations of Clark it appears what is possible under a certain guidance and an adequate instruction of economic life, and at what moment and in what direction intervention will be necessary. For that will have to be the case as soon as it appears that

actual production and actual exports, without any apparent reason, fall behind what is possible.

We have already made it clear that as a starting-point for affecting international commercial intercourse the situation should be taken that would arise under a free-trade system; this should serve as a 'model'. This does not necessarily mean that individual merchants should indeed be left entirely free, even to follow practices which in the past have proved to be the drawbacks to absolute freedom; a certain measure of organization, on the contrary, to prevent abuses, double work in propaganda and acquisition and too great variability is desirable. Such organizations have already sprung up from free industrial life on the one hand and from the governments on the other, and one should be open, at any moment, for new constructive proposals in this direction. It is also a good thing if great upheavals in development — owing to heavy foreign competition, whether or not arising as a result of new technical processes — can be absorbed or prevented by international consultation. All this need not derogate from the principle that no systematic fencing off of certain countries or groups of countries with regard to other territories must be allowed. Tariffs, prohibitions and quota systems should gradually disappear.

It is especially the fear of competition by countries with a low standard of living that must be considered as unfounded, prompted as it is by group-interests or by the slump mentality already mentioned. Besides the facts of newly arising branches of industry in these countries, which are competing with ours, there are a number of compensating facts which should not be lost sight of. In the first place these countries form a field of investment for the

redundant formation of capital in more prosperous territories and are consequently at the same time customers of a number of industries of means of production in the more highly developed countries. The U.S.A., Great Britain and Germany as well as, for instance, Holland are regularly exporting considerable quantities of capital goods to the less developed areas and this is nothing but a natural division of labour. Countries with a low standard of living also contribute in another way to the prosperity of other countries, namely by supplying cheap products, by which the cost of living decreases. Consider, for example, the cheap Japanese toys, bicycles, lamps and so many more products, which made it possible for these goods to come within the reach of much larger groups of the population.

Competition should only be fought with economically correct means; not by stupid fencing off. In this connection the raising of one's own achievements should be mentioned in the first place: the improvement of quality and the reduction of cost by more efficient methods of production. All this takes place regularly, and generally at a rate that has proved to be sufficient for a great number of years. In the Netherlands, for example, the productivity of labour in industry increased each year by 3 %, in the period covering the years 1929–1938. There have been countries, such as for instance Great Britain after 1921, that have not been able to keep up with this pace. This was justly considered as a point to criticize British industry, which was described as conservative and sleepy in many respects. Since then many new ways have been found also there — more intensive research-work in science and organization especially — to join in the race again with success.

A second means is a correct economic policy. In this connection its special task is to localize the occurrence of

temporary unemployment. If by the loss of foreign outlets unemployment is caused — say in the cotton industry — it will spread but for measures of economic policy and first affect engineering industry, which receives fewer orders from the cotton industry. In consequence of this depression in engineering, also other branches will now be affected, unless the government succeeds in compensating the slump in the engineering industry by giving additional orders. In this way the depression in the cotton industry can be localized, until new possibilities of production arise in that branch of industry itself or elsewhere by the normal increase of productivity.

A third way becomes necessary, if the collapse should be persistent and the increase of productivity insufficient to open up new export possibilities. Then the consequence of the apparently decreased achievement of the country should be accepted either by reducing the general wage level or the rate of exchange, in order to raise in this way the competitive power of the country again and enable the labourers that have been rendered idle to find employment again. About the degree in which this latter means can work, something at any rate is known from the experiences gained with devaluation after 1930. For five countries on an average it could be ascertained that a 10 % reduction of the rate of exchange resulted in a 7½ % increase of employment[1]. For Holland this would mean an increase of employment for about 100,000 men.

From several quarters it has been asserted — and this conception seems to have found many adherents in England, too — that the payment of high amounts for interest and redemption of war loans will make it necessary for the

[1] Cf. De les van dertig jaar, ch. 11.

countries concerned to curtail foreign trade, especially imports. Also this conception, however, is only to be understood from a slump mentality. We have seen that in a free-trade world the productive forces of every country are applied most efficiently; consequently the national product will be as large as possible; hence it is easier to effect a payment of interest and redemption from it than from the smaller production which is the result of protection in whatever form. We emphasize again that this only holds good when full employment of the productive capacity is guaranteed. In Great Britain it is intended to use every endeavour for this purpose. Then, however, protection is indeed unnecessary and can only be advocated by him who, consciously or unconsciously, takes a state of depression for granted. We may also argue in this way: by restricting imports, part of the internal purchasing power is prevented from applying to foreign countries. Then it is sure to appear in the home market. It there is full employment, this means that exports are reduced to the same extent as imports are reduced. Consequently nothing has been gained to obtain foreign exchange. Of course it cannot be denied that there is a certain limit to the paying-capacity of a country, if it is desired to effect these payments in money and that this capacity can be increased by supplies in kind. But this does not prove the necessity to curtail imports: supplies in kind signify by no means a form of protection of any country. In the light of these considerations it is not quite clear at present what people in Great Britain think they will attain by a regulation of imports, when at the same time they will try to realize full employment; an unconscious fear that it may not be possible to maintain this full employment presumably plays a part here. For the sake of international cooperation it is to be

hoped that, under certain conditions, they will be ready to reconsider this standpoint.

When in the above we have advocated an approach to free-trade conditions, this does not mean to say that we are pleading for a sudden abolition of all trade barriers. Sudden and extensive changes in the economic order usually bring about incalculable and in many respects harmful reactions. So the transition be gradual. For the rest, international trade is sure to be limited in many respects during the first few years after the war, which ties it will only gradually be possible to loosen. So there will be a natural breathing-space, in which trade and industry can prepare for the necessary adaptations, if the intentions for later are clearly formulated already. This adaptation can be facilitated by studying cost levels in various countries for a number of branches. Without further studies it will not be easy to foresee in which branches of industry changes will take place. Opposite the high wages in the U.S.A., which are the principal cause of the protective rates there, is the very high productivity of labour. It is sufficiently known that, in spite of these high wages, the U.S.A. can compete very well in the domain of the engineering industry and associated branches. In what other domains it will be impossible for her to compete is less easy to see and will have to appear from the studies mentioned. For the future export possibilities of other countries this point is of the greatest importance.

If it is possible, therefore, already to prepare one thing and another in the period of transition, the actual reduction of hindrances could moreover be spread over a period of say five to ten years.

Chapter IX

INTERNATIONAL MOVEMENTS OF CAPITAL

After dealing with the international intercourse of products in the preceding chapter, we shall now consider the intercourse of production factors. In chapter VII we already pointed out, however, that during the first few years after the peace treaty there can be little question of a movement from one country to another — in a direction that is justified from the social point of view — of the factors nature and labour, or in more ordinary terms, of territory and population. For this a sounder mental and political unity of the world is essential. Therefore, only the supply of capital by one country to another can be considered. It is on this that we will dwell in some more detail in this chapter; at the same time we shall then deal with the settlement of war-debts and reparation payments.

As pointed out in chapter III, the export of capital is a means to attain a certain measure of levelling in the prosperity of the various nations. A transfer of capital from say the U.S.A. to China means that the former country allows the capital quota in her production to rise a little less strongly than otherwise would have been the case, whereas the latter country attains an acceleration of the development of her capital quota. As a raising of the capital quota, as pointed out in chapter I, raises the productivity of labour, productivity in the U.S.A. will by this transfer develop a little more slowly than otherwise would have been the case and in China a little more rapidly. By a sufficient transfer of capital, therefore, a drawing together of the productivity

and hence also of the prosperity of these countries might be attained. I regard this diminution of the differences in prosperity as an important economic contribution towards the ultimate consolidation of the world's social system. At present, quite different problems prevail, it is true: the creation of a sufficiently strong governing centre and of guarantees for peace, also the finding, if possible, of a basis for cooperation between the Russian and the Western world are the principal of them. But they are not economic problems. It should be expected, however, that the large differences in standard of living between the Western world and the Far East will sooner or later lead to new tensions, for whose prevention every effort ought to be made. And in this connection a correct economic policy can have a great influence.

It will not be a simple matter to diminish the great differences in prosperity between East and West. It has been advocated simply to dictate to industrialists in the East to pay higher wages; hence a levelling 'by decree'. As to the incomes of farmers similar measures have been suggested. However, they will have a very limited effect only. For the root of all the trouble is that the production of these countries, per head of the population, is so small. If it should be dictated that higher wages were to be paid, the best employers would probably be able to bear this, not, however, the many working on the borderline of remunerativeness. These would be compelled to dismiss their workers, which would cause great unemployment and disorganize economic life.

It is theoretically imaginable that the prosperous countries should present a considerable and yearly flow of goods to the poorer ones: an international social policy analogous to the internal social policy in Western countries,

to be based on the consideration that the standard of living of the Eastern races is inhumanly low and that this is partly due to the fact that the Western countries are the big owners, especially of capital goods. For such a policy, however, the world is certainly not yet ripe; apart from the question whether this may be undesirable in other respects. It would be a more realistic policy to increase production in the Eastern countries themselves; then these races would, in a certain sense, help themselves, which is always a sounder basis for improvement.

In what ways is an increase of production attainable? There are three possibilities deserving our main attention:

a. raising the technical capacities of the population;

b. improvement of production-methods without raising the capital-quota: i.e. by a more rational arrangement of production, in the widest sense of the term;

c. increasing the capitals participating in production.

All three of these possibilities are already being applied in the countries meant; there is improvement in education, in technical instruction. The views on rationalisation, born in Western countries, are also penetrating there; and there is in those countries a formation of capital — though small —owing to which, also in their own strength, a heightening of productivity is reached. This process, however, could be considerably furthered in some countries, particularly in China and India, by international cooperation. In a country like China internal political order occupies a key-position: no economic prosperity is possible if it does not possess a minimum of stability, which, unfortunately, is frequently conspicuous by its absence. In the last decade, the war with Japan has, moreover, been a disintegrating factor of importance. Only when internal order has again been es-

tablished in China can it be hoped that the risks of capital investments have become so much smaller that their resumption may be anticipated. By international political cooperation the position of the Chinese government can be strengthened in the first place. Besides — and this is of great importance — the import of capital could be promoted by international economic cooperation; e.g. with the aid of a system of guarantees, to be given by the international authorities, to whose jurisdiction these matters belong. As such the newly created *Bank for Reconstruction and Development of the United and Associated Nations* is probably best suited, of which it may be hoped that it will become a powerful and well-managed institution. Through the possibility of such guarantees, which, of course, will not be granted to countries whose financial organization does not meet certain requirements, an educative instrument for this financial organization itself may be obtained at the same time.

In order to get some idea of the size of the capital movements that might be expected on the ground of what has been argued above, we ascertain in the first place what are the differences in rate of interest between the more and the less prosperous countries. In the following table some data have been collected:

Return of debenture bonds in %	1929	1932	1937
U.S.A. Treasury Bonds, currency > 12 years	3.60	3.68	2.68
Great Britain, Consols	4.60	3.76	3.31
China, Reorganization loan 1913	8.23	8.26	6.00
India, 3 ½ % government stock	5.27	4.75	3.82
Finland, state loans	7.7	8.4	4.7

It will be seen that the differences are considerable; they are attributable to at least two causes: to differences in

scarcity of capital and differences in risk premium. For a country like Finland it may be taken, certainly for 1937, that the last factor was absent; for India probably, too. For China both factors will have to be taken into account, for reasons explained above. The supposition that it must be possible by international cooperation to lower the rate of interest in China by 1/5 does not look fantastic in the light of the above figures. How much more capital would be demanded in consequence? Only the work of P. Douglas[1] gives information about the elasticity of the demand for capital; his results justify the assumption that this elasticity amounts to 4/3, i.e. that a reduction of the rate of interest by 20 % would lead to an increase of demand by about 27 %. Colin Clark[2] values the total capital invested in China at 35 milliard I.U.; the increase of demand by a 20% reduction of interest rates would then amount to 9 milliard I.U. For the sake of comparison we mention that, according to Clark's calculations, an annual import of capital might be reckoned with for the future of 3 to 4 milliard I.U. Hence it is evident that the extra capital import resulting from a reduction of risk-premiums is of an extent not to be despised. Should it be possible to push this levelling process still further — and in view of the above figure there is some ground for this — considerably higher figures might even be reckoned with.

Of course, these evaluations are highly speculative. They are based on very crude investigations and on tendencies which can only be ascertained in rough lines. We consider our evaluations just a sufficient motive for the necessity of a more thorough study of these problems. It

[1] P. H. Douglas, The Theory of Wages, New York 1934 and later work.

[2] C. Clark, p. 80.

may be observed that with regard to investment possibilities in the near East, including South-eastern Europe, similar conclusions are reached.

Particularly as to China the question is of importance which country will supply China with the necessary capital. Russia seems to lay some claim to the opening-up of China. In this connection we wish to point out that, according to Clark's computations at any rate, it is little probable that Russia will be able to raise the necessary capitals. It will almost entirely need for itself its capital formation covering the period 1945–1960 of about 175 milliard I.U., whereas the United States will be able to export about 60 milliard of their savings amounting to about 220 milliard I.U. It is logical, therefore — and in the interest of a levelling of prosperity — that the United States should have a large share in the development of China.

From the importance we attach to this supply of capital to the less prosperous countries it follows that we also consider the continuation of capital formation in the prosperous countries as necessary, or at any rate highly desirable. In the last few decades it has been argued that continuation and increase of this capital-formation is undesirable and superfluous. Those who have proclaimed these views mostly based themselves on a national standpoint; they did not consider the possibility of capital export or rejected it for one reason or another. Moreover, they started from the conception that a further increase of the capital quota in the internal production of the prosperous countries is either impossible or does not pay. The latter view need not be rejected. It is indeed imaginable that in the country that occupies a leading position in technical development, the new technical processes corresponding

with a further increase of capital structure are not yet known. It is likewise imaginable that a further rise of the capital quota is unremunerative. If there were no possibilities for capital export it would then be better, indeed, to form less capital and to use the released productive power for the production of articles of consumption. In other words, a larger share of the national income would have to be spent on articles of consumption and less would have to be saved. As soon, however, as there are also export possibilities, this is no longer the only solution. Then also less prosperous countries can in this way be aided in their development. And from the viewpoint of international stability the latter possibility is then preferable. It is also preferable because by it the total capital wealth of the world and hence the total possibilities of prosperity for the future are increased. Thus it means a certain sacrifice by the present generation in the more prosperous countries in behalf of the less thriving nations and in behalf of the future. So we have no objections to high savings in the wealthy countries, but on condition that they are not hoarded, as often happens in times of depression. For this means that part of the productive forces remain unemployed and that is on no account to be desired. Efforts should be made to avoid this by a good employment policy.

We find support for our views in the calculations of Colin Clark[1]. They show that for the continuation of the rise in labour productivity very considerable capitals will be required. These are estimated by him from the relation between the height of per capita production and the capital, per head, which he believes he can compute from his — very extensive — statistic material. If one takes these computations as a starting-point, the need of capital is even greater than the world savings that can be expected.

He computes these savings from the relation, as found in the past, between national income and savings. With an estimated total of savings between 1945 and 1960 of over 800 milliard dollars (having the buying power of 1925–1934), there would be a deficit of over 250 milliard. Should the disposition be continued to save less on a given income than before, his estimation of the savings would even be too high and the deficit in them still greater. Likewise this deficit would be greater than Clark computed it, if a correction is made in his estimate of capital requirements, for which there is certainly some ground in our opinion[1].

Even apart from the capitals which it will be possible to employ in the development of less prosperous territories, considerable capitals will be required immediately after the war for the reconstruction of the capital goods destroyed by the war. Besides this capital destruction the war has, for a number of countries, also led to very great national debts, which are partly of an international character. Among these international debts which, from the standpoint of a given country, can be added to the capital destruction in material goods, the lease-lend debts to the United States occupy a very important place. On June 30, 1944 America had, on the basis of the lease-lend act, granted advances to an amount of 28 milliard dollars, 9 milliard of which had gone to the United Kingdom in the form of goods, and besides that presumably over 1 milliard dollars in the form of services. On the other hand, there was reverse lend-lease aid by Great Britain of some 2 milliard dollars.

[1] It would lead us too far to enter here into greater detail. We have dealt with this problem in a discussion of Clark's book in the Revue de l'Institut International de statistique, 1945.

The United States themselves will be able to bear their capital losses caused by the war more easily than other countries, because these losses, as compared with their very great wealth, are smaller. Moreover, the safe geographical situation of this country has naturally prevented the destruction of capital by devastations. Only the diminution of stocks and the non-replacement of worn-out plant have to be recorded there as resulting from the war. Hence no country is in a better position to lend a helping hand to other states than exactly the U.S.A. Thanks to the fortunate circumstance of the safe geographical situation of their territory and of their great productive capacity it will be possible to reduce to smaller dimensions many of the disastrous consequences of the war. If the countries that have been particularly ravaged by the war should have to surmount in their own strength the results of these capital destructions, they would have to face almost insoluble difficulties. Their labour productivity has declined to such an extent that perhaps they would even be unable to produce a minimum standard of consumption goods; not to speak of a production, beyond that minimum, of the necessary capital goods for the reconstruction of their devastated plant and the replenishment of their exhausted stocks. They would consequently become 'depressed areas' in the world for a great number of years and exercise an adverse influence on the economic conditon of the world: for instance, they would be unable to resume their former imports to any appreciable degree. All this can be reduced to far less serious proportions, if the U.S.A. aid these countries — among which also Holland is to be reckoned — by supplying capital for their reconstruction. The old efficiency in production can then be restored rather rapidly and the taking up of these countries in a more

normal world economy is only a matter of a few years then. For a number of countries, however, this aid would result in new debts being added to those already existing, and the total amounts of interest and redemption which will then have to be raised by countries like the United Kingdom and numerous smaller ones, will be very considerable in proportion to the remaining items of the balance of payments. It is questionable whether such countries will be able to raise these sums without endangering the stability of their balances of payments and whether, in this connection, it would be in the interest of a stable and prosperous social system of the world to maintain them. If it is considered that the United Kingdom, instead of its foreign assets in 1938 of 3.6 milliard pounds sterling will have a debt after the war of at least an equally large amount, owing to which the item of interest and redemption will stand on the other side on the balance of payments—and will probably be higher—this is already a sufficient indication of the tremendous difficulties that are threatening. Therefore it would be an act of wise statesmanship if part of these debts were cancelled — a thing for which also in the U.S.A. voices have been raised already. Such cancelling is also in the interest of the United States itself, as otherwise it will compel the debtor countries to cut-throat competition in the export markets, of which it would thoroughly feel the reaction in its own exports. A cancellation may perhaps also be motivated in this way that, after all, the exposed situation of Great Britain, as well as the safe situation of the United States with regard to the foci of war, are accidental, viewed from the standpoint of world economy and world politics; they are no mistakes or merits of the countries concerned and therefore the debt-relation arising from them has no economic foundation.

As for the reparation payments to be made by Germany and her allies, similar, though not identical, considerations hold good. Also here it will be wise to be guided in the first place by the interests of a stable social world system with a prosperity as high as possible. Viewed in this way, the limits should be taken into account which, over a longer period, are put to the capacity of a country. If they are ignored, exhaustion will be the result, which will sooner or later revenge itself, also for countries which thought they could benefit by it. The actual limit put to capacity can be found by reducing the maximum production by what is needed (a) for a minimum subsistence of the population, and (b) for reconstruction purposes, as far as this is necessary to continue or resume production. In this connection it should be borne in mind that, if the standard of living of the population is put too low, this will automatically revenge itself in the level of production. Under high pressure it may be possible to dodge this law for some years, for a policy of longer duration it cannot be neglected.

We will illustrate our thesis with some figures. The value of Germany's production, measured by the national income, amounted to 82 milliard Reichsmarks in 1938. We may, for the average of the first five post-war years, reckon with a production of almost the same amount; then we shall probably be far too optimistic yet as to the speed with which productivity can recover. What, now, is the value of the minimum consumption of the German people that can be maintained for years at a stretch without undermining production ? In order to estimate this amount, we consider that the Dutch people — which, by 1938, had about the same standard of living as the Germans — in 1943 already underwent a limitation of consumption, greater than could be maintained in the long run. This reduction

amounted to approximately 25 % compared with the level of 1938. A reduction meant for a longer period, therefore, cannot exceed 20 %. As in 1938 about 3/4 of the national income was spent on articles of consumption, or 62 milliard Reichsmarks, a reduction of 20 % of that amount, or 12 milliard, will be possible. This amount would thus be released for reparations, except for the part necessary for the reconstruction of their own productive apparatus. For reparations could likewise be used the 20 milliard Reichsmarks, spent in 1938 on new investment and armament purposes. The devastations are now such that the reconstruction will take at least 20 to 25 milliard a year. Consequently 7 to 12 milliards remain for reparations, or say 10 milliards. We look upon this figure as a maximum, and expect that later calculations, which will only be possible when the actual situation is known, will yield a lower figure. This becomes all the more probable, if the disinvestments should still increase. Moreover, a figure is to be expected for the first two years that is far below the average of the first five years, and which might very well prove to be negative, which means that Germany would in reason be incapable of any achievement.

An amount, like the one calculated above, of 10 milliard Reichsmarks, could only be transferred by supplies in kind — or an arrangement equalling this; as we shall show in more detail (in chapter X), a transfer in money in the usual manner, leaving commercial intercourse unhampered, could only be effected for a small part. After the last war supplies in kind were not received with great enthusiasm by the receiving countries; the supplies of coal, for instance, were very soon felt as a competition for their own mines, and as a result they were crossed off the list after a few years' time. With a well-organized economic life this

competition need not be feared so much, but even then difficulties will remain if the supplies are too one-sided of composition. Only in case a great additional shortage has arisen of certain goods, which is sure not to be filled at short notice by home producers, will there be no objection to these supplies in kind. As is known, Russia claimed supplies in kind from Rumania in the form of work done by Rumanian labourers. It stands to reason that, in a country with great devastations, these can be usefully employed for a considerable time. Countries demanding reparation payments to high amounts should, however, be well aware of these difficulties and consider carefully whether they wish payment in kind. If not, they will have to be content, for the former reasons, with lower amounts than those mentioned above.

CHAPTER X

REGULATION OF FINANCIAL TRANSACTIONS

For a realization of the international economic aims discussed in chapter VI, not only the real economic relations between countries, but also the financial and monetary ones should be regulated. For from the latter may emanate, as was shown by the past, independent disturbing influences. It is particularly autonomous measures with regard to international payments, as taken by certain countries — and we are thinking of the devaluation of currencies as well as the putting up of all sorts of barriers by clearing, etc. — that have often caused great harm to other countries: this national, arbitrary procedure must be discontinued. As positive demands in this domain we can formulate: the greatest possible stability in the rates of exchange coupled with the greatest possible liberty in financial transactions.

The simplest theoretical solution would undoubtedly be the introduction of a *world currency*. By this is meant the introduction of one and the same currency for all countries, which consequently would be legal tender all over the world. All problems with regard to fluctuations in the rates of exchange would then become a thing of the past; it would not be necessary either to support weak currencies, and there would be no sense in a regulation of international payments by one country. In order to realize this ideal, however, the creation of this currency would have to be in one hand. In other words, only one central bank would be the real central bank of the world and the others only branch-establishments of it, or there would have to be such

intimate cooperation that the issue of money would be spread over a number of central banks. The cooperation would have to be very intimate, indeed! It would not be possible to tolerate that one country should, on its own authority, issue means of payment for too large an amount, owing to which the stability of the income and price relations would be threatened, also in other countries. Even too sharp discussions about the financial management might already lead to undesirable effects with regard to the confidence in the currency. If one thinks of the political relations of the moment — e.g. of Russia's desire so far to be economically closed — it will be clear that this world is not yet ripe for the introduction of a smoothly functioning world currency system.

Another possibility is a system of national currencies which are practically independent of each other, and consequently fluctuating with regard to each other. Apart from certain advantages concerning the possibility of adaptation to changed conditions, such a system shows many great drawbacks. The possibility of national arbitrariness is extremely great: the degree of confidence one could have in the fluctuating currencies of financially or morally weak countries would be rather small and the possibility of a disturbance of equilibrium would remain very great. In a way we have witnessed such a system after 1931, and, viewed internationally, it does not tempt to a repetition, except in case the economic policy of the great countries should remain far below the demands we formulated for it above. If in consequence of this every country itself must look after the best possible employment of its productive apparatus, fluctuating currencies may be unavoidable.

Viewed internationally, however, the preference should

be given to a system which on principle has the approximately fixed relation between the currency units in common with the gold standard, which can most easily be realized by coupling it with gold. For this purpose, as we shall further explain, also a measure of active coöperation is necessary, but this is within the limits of possibility and has, in fact, made good progress already. The coupling to gold need not have a quite unelastic character; it is imaginable — and has already become reality in the arrangements reached by the International Equalization Fund — that changes are allowed within certain limits when serious grounds can be produced. A country which loses part of its outlet through changes in international conditions and which, for social and other reasons, wishes to avoid a lowering of its wage and price level, can acquire new export possibilities by reducing its rate of exchange. Such a country should not be deprived of this possibility. It is desirable, however, that such adaptations cannot take place at any moment and to any extent, but are subject to certain limitations as regards time and extent. Thus it has also been arranged by the International Equalization Fund.

In this connection it is not necessary to think of the gold standard in one of its old forms only; at any rate, government bonds can also be accepted as cover by the side of gold, and for smaller countries also currency of the bigger ones, as for that matter was the case already in many countries. Naturally the advantage of the goldless standards is that then the improductive production of gold can be stopped.

The fundamental difference between the gold standard based on a pure gold cover, and a free standard for which — through poverty — only government securities are used as a basis, of which it is then said with some pathos that

it is a labour standard, is not so very great, as we observed already in chapter IV.

As we explained before, it is possible, however, to go much farther yet, and add to the means of cover other materials than gold; particularly a whole assortment of raw materials. It may be done in this way that 'parcels' of raw materials, of a fixed prescribed composition, are considered as equivalent to gold. Thus it might be attained that, within certain limits, the average level of the prices of raw materials would remain constant. For the stabilization of economic fluctuations this would mean a force to the good. The prices of the separate raw materials would not be bound by it; they could continue to indicate the relative scarcity position of those goods and by this continue to contribute to a sound automatic regulation of their production and consumption. Further it would not be necessary for all central banks to accept this cover — which is more difficult of administration — but only some of the greatest. Nor should it be thought that the raw materials would have to be present in kind in the banks: only the warehouse-warrants relative to certain stocks would have to be transferred to the bank.

In the case of one of the systems indicated above, which are more or less related to the gold standard, the rates of exchange would — but for some incidental changes — have to be stable. It is essential for this that the balances of payments are in equilibrium, both in the short and in the long run. This would be attainable by means of a complete regimentation of international payments, in the way that Germany knew before and many countries during the war. Owing to the many formalities connected with it and the consequent loss of time such an arrangement puts a heavy burden on the back of industrial life, which it will

be better to avoid. We would not advocate it as a normal condition; but the threat of it might have a great preventive effect. If speculative or other fitful capital movements should menace the stability of the rates of exchange, introduction of it might be necessary and also desirable. If, however, the remaining measures advocated here, are successful, the cause of such fitful capital movements will be considerably less than before and it may be hoped that it will be unnecessary drastically to restrict financial intercourse. These considerations do not hold good for a country like Russia, with a state monopoly for foreign trade; there payments are automatically subject to the supervision of state organs and the equilibrium in the balance of payments can easily be maintained.

For countries with a freer economic system a maintenance of the equilibrium for a short period is possible without special measures, if only they have sufficient reserves of gold or foreign currency at their disposal. In order to make this possible for all countries concerned, there should be a somewhat proportionate distribution among the various countries of the reserves available in the world, or it should be possible rapidly and simply to grant new credit to a country that is involved in difficulties. It is intended to meet these requirements by the establishment of the International Equalization Fund, owing to which also coordinated action is possible. It may be taken that no great difficulties will arise in this connection, as long as it is necessary to bridge over a temporary shortage of means of payment.

In order to prevent these shortages from becoming chronic, however, there should be an equilibrium between the items of the balance of payments in the stricter sense — consequently without the balancing items. As explained at

length in chapter V, it is by no means certain beforehand that, at a given position of prices, wages, production and rates of exchange, there will be such an equilibrium. It has been thought that the equilibrium can always be found by an efficient regulation of the rates of exchange, and for a number of cases this is even probable. In such cases it may be put thus that a certain currency is overvalued or undervalued with its existing parity and that by changing this parity the equilibrium can be restored. The normal case is that, when the payments annually due to foreign countries exceed the receipts from abroad, the currency concerned is overvalued and that devaluation can restore the equilibrium; exports—in their widest sense—will then rise more strongly than imports. However, we have also shown in chapter V that quite different situations may occur, when a reduction of the rate of exchange does not lead to a restoration of equilibrium, though it does lead, as it always will, to an increase of the volume of home production. Further investigations into the connection between the phenomena have shown us that, as far as the rate of exchange has any influence, it is in a way a secundary influence which it exercises. What is of primary importance — apart from exceptional cases — is that there should be monetary equilibrium within the country; in this sense that the incomes of the aggregate individuals and corporations are entirely spent on consumption goods, services and new investments, and that no hoarding or dishoarding occurs, with the latter of which creation of credit can be put on a par. All this to be conceived in this way that the dishoarding or creation of credit at any rate is not greater than what is necessary for a normal expansion over a longer period; in other words that no extreme inflationary policy is carried on, as was the case in Germany during

the years 1920–1923, and that no cyclic fluctuations occur in the hoarding and dishoarding. This latter demand, consequently, which applies to more normal conditions, comes down to a repetition of the demand for a correct trade cycle policy. This demand is, as we already pointed out, first and foremost a demand made upon the national economic conduct of the big powers. If this fulfils the conditions of a good trade cycle policy, an important factor to the good is already active for the small countries, too. In order further to assure also these countries of a stable economic position, it will moreover be necessary to make an end of autonomous changes in commercial policy (cf. chapter VIII).

Finally, a factor which does not belong to the normal economic picture, but one which will play a part of especial importance after the war, is that of the payment of interest and redemption of war debts and of reparation payments in money. When these payments — which we shall call 'unilateral payments', because their improductive character involves that there are no counter-items in the form of higher exports — exceed a certain level, monetary equilibrium likewise threatens to be disturbed and therewith the equilibrium in the balance of payments.

As in the relative literature, it is efficient here to distinguish between two difficulties that may occur. The first is the so-called transfer problem, the second might be called the difficulty of achievement.

The transfer problem consists in payments to foreign countries only being possible in foreign exchange, and — apart from the exhausting of stocks still present or the contracting of new credits abroad — this can only be obtained from a surplus of exports in the widest sense over imports. There are limits to this surplus especially for the

reason that there are limits to the value of exports. As we explained in chapter II, the value of exports cannot be increased at will or almost at will, as the classical theory would suggest; on the contrary, there are limits to the possibilities of increase. We get a clear idea of this when we start from the fact that a reduction of the price of export products by x % results in an increase of the quantity by $2x$ %[1] If we calculate for various price reductions what the total value of exports then becomes, we get the following table:

Price	Quantity	Value
100 %	100 %	100 %
90 %	120 %	108 %
80 %	140 %	112 %
75 %	150 %	112 ½%
70 %	160 %	112 %
60 %	180 %	108 %

All figures are expressed in % of the original values of the three quantities concerned. It is evident that there is a maximum value which is only 12½ % over the original value. If it should be assumed that the export quantity rises $3x$ as much in percentage as the price declines, the maximum appears to lie higher, but even then only 33 % over the original value. Statistical investigations having made it acceptable, as we saw, that the relation between the percentage of rise in quantity and the percentage of decline in price is under 3 rather than over, there are accordingly rather narrow limits to the increase of export value. Then it should be borne in mind that, when the quantity of exports is to rise considerably — in the above example by 50 % — imports will also have to

[1] The figure 2 then approximately represents the so-called substition elasticity of exports.

rise, owing to which the balance will become smaller than has been calculated. A closer investigation of possibilities shows that, consequently, the maximum of export balance depends both on the elasticity of exports and of imports as well as production, but that the above limits, as to relative size, give a correct picture of the situation. Regarding some more exact computations we refer to appendix I.

When by the side of these figures the amounts are placed which, at the present level of war debts, a country like Great Britain would have to pay, it becomes clear that much may depend on a correct regulation of these debts and their payment. The same thing holds good for the regulation of reparation payments, as far as they would have to be made in money.

The foreign assets of Great Britain had a nominal value of 3.6 milliard pounds sterling in 1938. In the beginning of 1944 1.75 milliard of it had been realized and had yielded only £ 1 milliard. The City estimated the value of the remainder at £ 0.5 or 0.6 milliard. On the other hand new debts had arisen to an amount of £ 3 milliard, besides the lend-lease debts of some £ 2 milliard; the total foreign liabilities would thus amount to £ 4 or 5 milliard. If for interest and redemption together 5 % is reckoned, a moderate percentage, this would mean a burden of 200 to 250 million pounds, against receipts of interest and dividends in 1937 of about £ 200 million! If it is considered that the value of imports and exports in 1937 was £ 953 million and £ 521 million respectively, it becomes obvious what difficulties a maintenance of these debts would entail.

Fortunately it is being realized already in expert and long-sighted circles in the United States that it is not in the interest of that country either to exact the full pound. For on the one hand it would endanger the monetary

stability of Great Britain — and with that of a large part of the world —; on the other hand it would compel the United Kingdom, its chief competitor in the world market, to launch such an export offensive that it would thoroughly feel the repercussion of that in its own export industries. When, moreover, one considers the origin of these debts, it is partly the exposed geographical situation of the United Kingdom against the safe situation of the United States; can these factors be looked upon as a serious foundation for financial relations in an efficient economic system? And how far, moreover, should the importance for America be taken into account of the political attitude of Great Britain at the end of 1940, then almost the only belligerent left on the Allied side?

If one views in the same way the transfer problem for possible reparation payments in money, to be made by Germany, it follows from the export figures for 1937 and 1938, which amounted to 5 to 6 milliard Reichsmarks, that such payments in money could not easily exceed an amount of 1 milliard Reichsmarks.

Such considerations hold good to a less degree if one manages to get round the transfer problem. This is possible by demanding payments in kind, as was done by Russia with regard to Rumania, which country, as has been pointed out, has to supply labour for the reconstruction of Russian territories[1]. It would also be possible by demanding supplies in the form of goods, to which this form might be given that the payments are at first made in money, but the stipulation is made that these amounts are to be spent in the paying country. The export surplus is then raised so much — if one likes: artificially — that the limits calculated

[1] This text was written already in 1944. The reparation claims on Germany have now also been given the form of payments in kind.

above no longer hold good. These only exist when the receiving countries are free where and how to spend the reparation payments. After the last war Germany made supplies in kind, e.g. coal; however, the receiving countries felt them as a competition for the national industry and after a short time they were crossed off the list. This feeling was based on an incorrect view, however; given a proper organization they could have benefited by these supplies without the chances of employment being injured by them. Generally it may be stated that, the better full employment is maintained by a correct economic policy, the better supplies in kind can be utilized.

In the case of supplies in kind, only the second difficulty mentioned before, the difficulty of achievement, makes itself felt in the paying country; this means, as we mentioned by the way in chapter IX, that there is a limit to the physical possibilities of supply. This limit is there where further supplies would lower the standard of living of the paying country so much that it would come below a human minimum. No doubt this minimum is a very vague idea, as the years behind us have shown clearly enough. By brutal force it is possible to press a population down to a standard of living which is considerably — perhaps even 50 % or more — below what was customary here before the war; a similar procedure, however, does not tally with our conceptions of humanity. A reduction by 30 % — corresponding with the level at which it is estimated that the Dutch population lived about the middle of 1944 —, already means an exhaustion at the expense of the future. Moreover, it should be borne in mind that also labour productivity is less at such a low standard of living, so that it is doubtful, even from the conqueror's standpoint, whether it is wise to go so far. Hence that in our compu-

tations of the preceding chapter, we believed we must reckon with a 20 % reduction of the living standard at most, from which we concluded — though with great uncertainty — that a capacity of much more than 10 milliard Reichsmarks cannot be reckoned with.

Separate measures against the 'vagabonding capital movements', which in the period of 1929–1939 caused so much trouble to the leaders of finance, are hardly possible, unless it should be considered advisable to proceed to a complete regimentation of international financial intercourse. As we observed before, we should prefer to see this used as a preventive threat only. This can be done all the better, if by a correct trade cycle policy in the principal countries, a curtailment of national autonomy in trade policy and in international financial policy, as well as a satisfactory settlement of international debts and reparation payments, many causes of instability and consequently of speculative capital transactions are removed.

It might be thought that a restoration of the gold standard or something akin to it signifies a return to 'laisser faire' and that by advocating this restoration the experiences of the period after 1919 should be ignored. This is not the case, however. If the conclusion is reached, as we did, that in spite of the existence of all sorts of possibilities for regulation in a certain domain, the condition of liberty should be approached as much as possible, because in that way the economic aims are served best, such a policy requires active supervision as to its observance. Formerly the governments did not know any better but freedom in financial intercourse was the only possibility. Now they have tasted of the honey of regulation and must

be kept away from it, which demands positive interference. This will accordingly be the task of the International Equalization Fund.

Important material decisions which the Fund will have to face are those regarding future parities. It would seem that, for the time being, the objective is to restore the parities of the West-European countries in the same relation to the dollar as existed before the war.[1] The measures for the French and Belgian francs and the Dutch guilder give ground for this supposition. It is possible that these parities are only meant for a certain time. Before stabilizing them, the governments should realize that the experiences gained after the last war with the restoration of pre-war parities, were far from favourable. We already pointed to the fact that the chronic depression in the United Kingdom after 1925, as well as the stagnation which production in Denmark and Norway showed about that time in comparison with Sweden and the world as a whole, is largely to be ascribed to the restoration of the old parities in those countries, after they had witnessed the development of a considerably lower rate of their currency during the first few years after the war.

If the rates of 1939 are to be restored without detriment to the volume of employment, certain requirements must have been fulfilled. A restoration of these rates would be justified in any case, if, first, 1939 had shown a well-balanced situation in this regard, and secondly, the changes in the conditions of competition had been equally great for all countries. There is room for doubt with regard to both these points. In 1939 there was in many countries a level of unemployment — though unequal — which

[1] Also this text was written in 1944. Since then parities have been fixed which are more in accordance with the views given here.

cannot be tolerated again in post-war years. And since 1939 conditions in the various countries have developed in a different way. It is true that the difference in the development of prices is not so very great, notwithstanding the fencing off of the occupied territories. The rise of prices in the Netherlands, for example, is not much greater than in Great Britain and the U.S.A. If the cost of living index numbers are put at 100 for 1938, the figures for the three countries are now 145, 140 and 130 respectively, and for wholesale prices approximately 160, 160 and 135 respectively. As part of the German economic area, and after it had once been adapted, the Netherlands showed a comparatively slow rise in prices — at any rate, as far as official prices are concerned —, but this was preceded by German quarters deliberately aiming at our insertion, which comes down to an increase of the former price-level by about 30 %. Originally the rise in prices was greater in the Anglo-saxon countries than in the German area, but since 1942 there has practically been stability.

Besides price movements there are other factors, however, which should exercise an influence on the choice of the future parity. For the United Kingdom, for instance, it should be taken into account that it is to expect a tremendous shift in its balance of payments against the pound sterling in consequence of the high war debts which it has had to incur. Unless a highly satisfactory settlement of these debts is reached, it will therefore need an increase of its exports, for which a lowering of the rate of the pound may be necessary. The Netherlands will presumably have to reckon with a serious decline in the purchasing power of its outlets, notably of Germany. On the other hand there is a possibility of more favourable export opportunities springing up for this country in the event of a freer com-

mercial intercourse. We do not intend to argue that from these few qualitative and incomplete observations it should follow already that a revision of parities is necessary, although a downward revision does seem justified. We only wish to point out that a more thorough investigation is highly desirable, in which the national interests of the countries concerned should be carefully weighed against the general, international interest. It is the task of the International Equalization Fund to make such an investigation, before they proceed to a more definite fixation of parities.

Chapter XI

THE NECESSITY OF AN INTERNATIONAL CENTRE

In the preceding chapters we have seen that in various respects a curtailment of national sovereignty is necessary with regard to economic policy, if a more stable and prosperous social system is to be realized in the world than we have witnessed since 1914. This curtailment of national autonomy is desirable in the field of commercial policy, in order to prevent the many arbitrary and unilateral limitations in international trade, which, notably since 1930, have caused so much harm. It is equally necessary in the domain of the technique of payments, in order to prevent arbitrary limitations in financial transactions as was done by the German regulations of foreign currency, or to prevent arbitrary changes in the rates of exchange of currencies of world-wide importance, such as the British pound or the American dollar.

We have also seen that international cooperation is desirable for a number of divergent purposes. Cooperation in the matter of a correct trade cycle policy is the first and most important point; cooperation in the management of an international currency reserve in order to reduce the risks of capital export and in an international control of cartels are some more forms, equally important. In the long run the countries will also have to come to the formation of a centre, from where the economic policy of the world is conceived and carried out, whatever the exact contents of this policy may be. It must be possible for the economic changes in world order which in earlier epochs could only

be attained by war, to be brought about in future by wise leadership and after public discussion, without war, if these changes are reasonable. Hitherto an organism was lacking for this purpose. The national centres of economic policy — the state departments of trade and industry of the separate countries — are naturally unsuited for this, because their task is the promotion of the national interests. The international centres which we have known so far were too much tied to definite, partial definitions of their tasks and, moreover, invested with very little power only. What is needed is an organism having the authority, on behalf of the international power centre, to take all the measures of economic policy which are necessary for the welfare of the world's social system, viewed broadly and for a long time, i.e. what Anglo-saxon writers have indicated as 'peaceful change'. Though the post-war atmosphere will probably not allow of this happening at once in that well-considered and undogmatic way which takes no notice of any group interests, it is to be hoped that it will be possible in the long run.

What I advocated above, even without these remoter objectives, comes down to proposing a certain regimentation of international economic life. I am now going to motivate this in some more detail. I am no advocate of a complete regulation of economic life in details and do not belong to the typical 'regulators'. Regulation within certain countries, apart even from what the war has brought, has possibly gone too far already. A substantial number of regulative measures has sprung up as a defensive weapon against the great depression of after 1929 and the hindrances to international trade resulting from it. If in future we may reckon with better regulated economic conditions in the world and with a curtailed sovereignty with regard to

commercial policy, a certain number of these measures can perhaps be done away with again. I am thinking of the regulation of agriculture in many countries, of the closing of certain branches of industry and of the restriction of production. I am therefore of opinion that some moderation in this respect may be welcome. However, if the regulation within the borders of the separate countries has perhaps gone too far, in the international field it is exactly the opposite. There is every reason to plead for more regulation there. This seeming inconsistency can be explained as follows.

In the first place there are forms of regulation which only have sense if they are international; think, for example, of the regulation of commodity markets, where competition has an international character. Nationally it is possible then to make shift by protecting the regulation with a tariff or quota-wall, but from an international point of view this solution is little satisfactory. In the past few decades this has been realized, too, and the most successful instances of market regulations — speaking purely technically, so apart from their purpose — were those where it had been possible to reach international agreement.

In the second place regulation in the international field is more urgent than within the borders of a country, because the existing situation in the international field generally shows more arbitrariness, in consequence of national sovereignty. In the preceding chapters, when discussing commercial and financial policy, we had again and again opportunities to remind the reader of this.

In the third place the lack of 'market knowledge' is much greater in international than in national markets. Compared with local and regional differences in circumstances, customs, etc. international differences are much greater, of course,

and thereby the chance of errors and wrong decisions. A notable instance is that of the capital market. It is far more difficult to judge of the remunerativeness of a new investment, of the measure of solvability, and of the dangers threatening it, in the international than in the national field; for this reason a system under which a guarantee is given by a mediatory authority is particularly desirable here.

In the fourth and last place it has appeared in our theoretical analysis, that exactly in the market which represents 'par excellence' the contact of every country with foreign countries, namely the exchange market, there is a special need of regulation, because here the price cannot under all circumstances perform its regulative function.

If, therefore, I am advocating a number of regulatory measures in the international field, the surprising feature in the results of our investigation has been that the concrete contents of these regulations have to be inspired by the 'liberal' theory to a larger extent than is sometimes thought. Particularly with regard to commercial policy and international capital movements it may be argued that the situation as represented by the theory of free exchange is, under certain conditions, the optimum situation, which is worth striving after. However, this conclusion stands or falls with the assumptions that it will be possible reasonably to approach a condition of full employment and that in the domain of politics international cooperation will be sufficiently close. Exactly because in the thirties these two assumptions had not been realized, it was logical that other solutions than those of the liberal theory were sought and found adherents in a fairly large circle. It is as logical, however, to revise one's opinion in the opposite sense

when the realization can be attained; on the condition of course, that full employment and international cooperation are also considered desirable in their effect. I think there is every reason for this. One need only read again the economic history of the Interbellum in order to realize what the alternative to international order means. It might be remarked that consequently I desire a return to the conditions existing before 1914 and that there was no conscious international regulation at the time; that, on the contrary, order existed and continued to exist 'of its own accord'. It may be replied that the resemblance of the aims formulated above with the conditions existing before 1914 is in various respects only superficial, but that, even if there is a resemblance in some points, it does not follow that also in the present world such a situation would arise again 'of its own accord'. As I already observed, there was a widely accepted notion in those days that the governments should refrain from any interference in the economic sphere; this is not so now; it has been found that it can also be done differently and the temptation to interfere is much greater for various groups of interests; at present a siruation as before 1914 can only be realized consciously, no longer unconciously, if I may use these words.

Therefore our considerations indeed prove the necessity of an international centre of economic policy. Considering the diversity of the subjects it will have to regulate, that centre can and must exist of different organs. It would have to be both an observation post and a centre of study, as well as — and this especially — an institution of guidance, supported by a proper power. This last point is all the more necessary as the interests of the individual states are looked after with so much more organization and purpose than, for instance, in 1919.

In discussions of experts or representatives of the United Nations a number of organs are already being prepared. We already spoke of the International Equalization Fund and the Bank for Reconstruction and Development; it is to be hoped that more such organs will be designed and that they may function well. Then we must also hope that the staff of the existing Secretariat of the League of Nations and the International Labour Office will be taken up. These bodies have given proof of being well-equipped for making investigations in the economic and social domains. Notably of late years they have published quite a series of important studies, which will be of great use for outlining future economic policy. These studies first of all refer to the trading policy as carried on by the principal countries in the period of 1919–1939, to the endeavours to get to a reduction of restrictions and the experiences gained from those endeavours about the technique of negotiations and the form of agreements. Other studies refer to the economic disturbances that arose after the last war and the conclusions to be drawn regarding an orderly transition of war production to peace production.

So far the organs have only been mentioned individually. It is obvious, however, that they ought not to act independently and therefore at a given moment perhaps in conflict with each other: their decisions must not be incompatible. Hence it is highly desirable that they should be vaulted over. Of this vaulting it may be hoped that it will develop into the seat of an all-sided international economic and financial policy, of which we spoke already by the way in this chapter: the centre that is to design the peaceful change of international society as far as economic matters are concerned, and that accordingly will learn to promote the general interest in contrast with

the interests of the separate countries and the interests of separate groups of producers and traders in international combination. It is beyond the scope of this book to enter into the question in what way it will have to be possible for the various national governments and groups of interests to exercise influence on the decisions taken by this centre. This question is part of the general problem of political cooperation in the international field, which we do not treat here. It must only be observed that expert knowledge for this work is essential and must not be subordinated to the representation of special interests. Both in the International Labour Office and in the Secretariat of the League of Nations experiences have been gained in this respect which do not call for repetition.

We conclude by expressing the hope that the work will not be done by halves, as in 1919. For once we may have an opportunity at present to achieve something. It is very doubtful whether history will grant us this opportunity again. It appears that the forces that can be unchained to destroy our civilization are so great that one gets the feeling: now or never!

Chapter XII

THE NETHERLANDS AND INTERNATIONAL ECONOMIC CO-OPERATION

The hope which always surged up again during the whole period of occupation and which, in spite of the arguments against it, became quite alive again during the liberation of Belgium, namely that Holland should get through the war without considerable devastations, has not been fulfilled. So we are now faced by the fact that, besides the exhaustion of our stocks and plant in the period of occupation, this country has been heavily damaged by the war. This naturally means that we have our work cut out as to relief and reconstruction work; may it be done with the necessary unity of spirit and also thereby quickly and efficiently. We shall not be able to do without international help. Thanks to the sacrifices of many, however, our prestige has certainly not suffered in the community of nations, and also on this ground we may assume that arrangements will be made. It is not the intention of this publication to enter into these arrangements of relief and reconstruction. Moreover, it would probably be too late already.

In this study we wish to speak of problems of longer duration, as, for that matter, has appeared from the preceding pages. For also these problems are already raising their heads: the work of reconstruction cannot be done quite independent of future possibilities. It is right, therefore, that the thoughts of many already go out to more remote periods: how about our possibilities of existence then? It stands to reason that for the Netherlands,

as a small country, this is a question with many international aspects; likewise that the questions of international economic co-operation are of great importance for our people.

Let us begin our discussions of these problems with the question, what position the Netherlands occupy in the community of nations. However much we have suffered from the war just now, it may be assumed that, thanks to our high degree of technical development, the quality of our soil and our trade relations, we shall, after a comparatively short time, be characterized again by what characterized us before, a fairly high standard of living — lying between that of most continental European countries and the Anglo-saxon world —, a less agrarian character than is usually thought — less than 20 % of our population works in agriculture —, and a national wealth invested for a relatively large part abroad and in Indonesia. Our imports form about 25 % of the value of the national product; they consist for a considerable part of the necessary raw materials for our industry, which is the principal source where our rapidly increasing population can find a livelihood. Our balance of payments was characterized by an import surplus, which was counterbalanced by receipts for shipping services, by interest and dividends. If a reasonable arrangement can be found for the foreign loans without which we shall not be able to do during the first few years after the war, there is every reason to believe that also these things will remain as they were, though the extent of our import surplus may have to become smaller. Hence comparatively large exports will be essential for the Netherlands.

In accordance with the economic structure of our country, free trade was always in its interest, also formerly;

likewise a well-functioning international financial system and good international cooperation. The Netherlands themselves practised free trade longer than any other country; it was not before 1933 that this country to some extent proceeded to quota-systems and to an increase of some duties. Then it defended the parity of the Dutch guilder with a grimness which was even detrimental to its own economic life; it was only in 1936 that it went off it, starting a depreciation which was the least of all countries.

Likewise there was always much interest, on the part of many kinds of experts, in international cooperation in other spheres than the economic. In contrast with this the interest in international politics, however, was smaller than might have been expected; in 1938 public life could to some extent be compared with a quiet island in an already boisterous ocean. Circumstances certainly have brought about a change in this respect, and it may be assumed that the Netherlands will draw the consequences in the matter of politics. It may especially be expected that it will be ready to put up with such restrictions of its national sovereignty as are desirable in the general interest. This has important parallels also in the economic sphere.

Compared with those of other countries. the prospects of Dutch exports are decidedly unfavourable for the near future, and doubtful for later. For the near future the destruction of our productive capacity makes itself felt as a factor on the side of supply. Our livestock is greatly reduced in number and underfed; we have hardly any pigs and poultry left. Our factory plant has partly been dismantled and taken away by the Germans, partly destroyed or insufficiently maintained and replaced. Rolling stock has been decimated; the railway bridges have been destroyed. Then there is the fear of increased competition

by the United Kingdom, which is in urgent need of enlarged exports in connection with its war debts, and by the neutrals, who are ready to start.

On the demand side the decrease in the demand for luxury articles will make itself felt, of which we produced a good many: bulbs, ornamental plants, grapes, chocolate articles. On the other hand it may be assumed that the demand for means of production (engines, harbour plant) and durable consumption goods (wireless sets) will grow. As to outlets, we shall have to reckon with a smaller demand from Germany, which was one of our principal customers (15 % of our exports in 1938), while also the situation in Indonesia will remain uncertain for some time to come.

For later years conditions may be viewed more favourably. Our productive capacity can be restored and the restrictions on the side of the supply will accordingly disappear for the greater part. As for agrarian exports, we may even hope for a favourable development. The computations of Colin Clark, quoted in chapter VIII, show that the demand for agricultural and dairy products, especially of high-grade types, is likely to develop favourably. This will become evident in the prices.

Clark calculates an increase of the imports of agricultural produce between 1935/8 and 1960 in:

Russia	of	4.3	milliard	I.U.
U.S.A.	,,	2.7	,,	,,
Japan	,,	2.9	,,	,,
Great Britain	,,	0.3	,,	,,
Germany	,,	0.4	,,	,,

From this it would follow — and it is not necessary to take the figures exactly in order to realize the probability of this trend — that it is advisable to develop our exports

to the first three countries mentioned. About the relation of prices (as compared with the average price level of industrial products) Clark states the following results: the prices of pork would rise by 70 %, of butter by over 30 %, of eggs by nearly 120 % and of cheese by 70 %. We repeat that these figures must not be viewed otherwise than as very rough estimates, dependent upon numerous factors the course of which is unknown. Thus it is possible that the mentality of industrial circles, particularly in the United States, will be in the way of a proper trade cycle policy and will reduce the possibilities for prosperity. But Clark's computations do take a number of the chief factors into account, the course of which *can* be foreseen with a certain degree of approximation. Up to now they are the best evaluations at our disposal. And they clearly counterbalance the too pessimistic expectations about the future of those who are overcome with the slump mentality.

Further it is evident that the Netherlands are greatly interested in a revival of international trade, and hence in a possible tendency to restore free trade. Should this be continued — and there are hopeful utterances from a number of prominent people in the U.S.A. which do not make it look quite illusory — it will also favourably affect the prospects for our trade. It would be an exaggeration to say that for our country free trade is a *conditio sine qua non.* If the trade cycle policy of the big countries should remain far below expectations, we should have to shift for ourselves and manage it, too. We have gained some experience in regard of quota-systems and currency manipulations, and could carry on a national economic policy. But the majority of the Dutch people would prefer to produce in a sphere of international free trade, and the country would certainly be better off. Various markets might then become

accessible again where we could compete in virtue of our achievements.

On the other hand, if we should live to see free trade more generally accepted again, the Netherlands should also cooperate loyally; it is our conviction that the country will do so. Not only with respect to the quotas within our European territory, but also to those in Indonesia. There is all the more reason to do this, because the exclusion of the cheap goods which in the Far East can be produced by our competitors, is against the interest of the Indonesian farmers, who with their small incomes cannot buy the comparatively expensive European goods. We must attempt to meet the competition of Japan, China and India by raising our own achievements, both in the foreign and in the home markets. As for the latter, there are still possibilities open. The educative work that has been done for some years past by a number of tradesmen's unions and by technical schools can be of great use in this respect.

If our own achievements should prove insufficient to face the competition of newly arising countries, a reduction of wages or of the rate of exchange would have to be resorted to. We already stated in chapter VIII that by a reduction of the rate of exchange an increase in employment, also for the immediate future, can at any rate be obtained, of sufficient volume to offset fairly heavy waves of competition. A reduction of wages can, especially in a slump period, unchain an unfavourable by-effect, which causes the results to be perceptible only at a later date. By coordinating such adaptations to altered relations of competition with a proper trade cycle policy, prolonged serious unemployment can be prevented and it can be seen to that Holland keeps the place in the commonwealth of producing nations to which she is entitled.

As far as the intercourse of capital is concerned, it may be taken that our country, after the work of reconstruction has been completed, will belong again to the countries exporting capital. The desiderata which we developed in chapter IX, if they are accepted as a line of action, then put on our country the obligation to contribute towards the evolution of the 'development areas' of the world. For the Netherlands matters are such that she can fulfil this obligation within the borders of her own empire. And this obligation appears under a particular aspect, now that the relation between the parts of the empire with regard to each other has again changed a little in consequence of political developments. Indonesia has made another stride towards the attainment of independency; it has somewhat less of the character of a colonial area again, somewhat more of that of a partner. The responsibility of the more prosperous part — the Netherlands — for the less prosperous part — Indonesia — will now be fellt all the stronger. Our task, to assure the population, especially of Java, of a life worth living, stands clearer than ever before us. Among other things, this will have to be attained by a further export of capital. The problem of industrialisation, as well as that of intensifying agriculture, should — now also as a problem of Dutch social policy — be studied more closely in this light, and the probable influence of a facilitation of capital-supply be ascertained. Then it should also be considered in how far the Dutch capital goods industry can be involved in the plans of development. If in this way the prosperity of the Indonesian population can be raised more rapidly, it is desirable to make also Dutch industry benefit by it.

Last of all, as regards international financial intercourse, there is not the slightest doubt that the Netherlands will be

ready to cooperate in any arrangement made for this purpose. It has even a distinct predilection for a solution which does not tie down financial intercourse too much. Our past has proved — we mentioned it already — that we were willing, even against our own direct interest, to play the game of the gold standard, when we stood almost alone.

We are certainly prepared to collaborate again on the basis of the new International Equalization Fund, particularly since the new parity of the guilder enables us to keep it stable. What we only hope for is that international cooperation will as soon as possible go into effect.

POST SCRIPT, AUTUMN 1945

The preceding chapters were written already in the autumn of 1944. The continued occupation as well as the paper and coal shortage in the Netherlands retarded publication. Many aspects of the problem of international cooperation have since got a more definite shape; many others are still as vague as they were before. A few remarks on the phase to which the long-term economic problems have come may be added.

In the monetary sphere things have become more definite by a choice of the parities for the French and the Belgian francs and the Dutch guilder. Fortunately these parities have not been chosen equal to their pre-war level: compared with the average sterling exchange rates in 1939 the French franc has been devaluated by 11 %, the Belgian franc by 26 % and the guilder by 21 %. As far as the guilder is concerned, it will certainly be possible to keep it on this level. Although there are, at the present time, some difficulties because of the decrease in labour productivity during the famine period, it will not be difficult to establish a new equilibrium between prices, costs and the present parity, as soon as regular imports of raw materials are resumed.

As to long-term credits some progress is also being made. Nevertheless, we must hope for a greatly accelerated development, if a really constructive international policy should be the aim of the United Nations. As with so many economic problems of the world, the key position is held by the United States. It is a supreme world interest that the immense productive machinery of that country can be kept running. For the near future there seems to

be some guarantee that production will go on. Many countries already gratefully absorb the flow of commodities emanating from it. In order, however, to have it continued, it seems that some fundamental changes in world financial structure are needed; and can we hope that public opinion in the United States will be ripe for them?

The problem to be faced before long — say one or two years — has been given this somewhat cynical formulation: how can the American government just present the other countries with annually say ten milliards of dollars' worth and yet make the American public believe they are doing good business?

This in fact is very nearly the real problem we are facing and the funny thing is that it actually is good business for the American people to do so. Throwing away ten milliards of dollars annually is presumably one of the few methods available for keeping the national income of the United States on a level, say, forty milliards higher than would otherwise be the case.

The International Bank for Reconstruction and Development seems to be the institute that is most appropriate for the performance of this task. What we must hope for fervently is an energetic guidance, by this Bank, of world development.

In the field of international trade a most important step has been the American decision to lower tariffs by 50 %. The need of an international centre capable to organise the spreading of this tendency is now being felt, however. Also here developments should be speeded up, if we are to use the chances offered. Quite the same is true for the supervision of international raw material markets. We cannot afford having a repetition of the events of 1919/1920

with their race for raw materials and the consequent boom in prices.

The most important spot of fatal uncertainty in world economics, however, is the German economic system. It seems that any elaborated and coherent plan as to Germany's reparation contributions, her volume of production and her standard of living is lacking. If so, we are evidently in urgent need of such a plan. If the Atlantic Charter is to be taken seriously and, consequently, European economic life to be brought on a humanly bearable level, a first necessity for the United Nations is to show what they are able to perform.

From these few remarks we may conclude, I think, that the urgent need for a powerful international centre is all the more clear. It is becoming clear too that if the United Nations should not succeed in establishing such a centre, it will be a vital necessity to the Western-European countries, Great Britain included, to collaborate on a more modest basis. These countries cannot, as the United States and Russia could perhaps, prosper by a system of autarky. In the absence of a world order they would have to try to come to a regional order at least. This collaboration would be purely defensive; and only a substitute for what they really want: an ordered world economy. We still hope, however, that this regional collaboration will not be necessary: that the new international organization will be vested with sufficient power and will attract sufficiently able men to start a new era. Seeing the task, the enormous possibilities and the urgent needs it would indeed be foolish not to take it up!

Appendix I

PROFESSOR GRAHAM'S CASE FOR PROTECTION

INTRODUCTORY

In the Quarterly Journal of Economics of 1923 Professor Graham[1] made an attempt to prove that, under certain conditions, international trade means a disadvantage to a country. His attempt concerns a country producing only two commodities, one under conditions of increasing, the other under conditions of decreasing marginal cost, of which the first is produced at a comparatively lower cost than abroad, the second at a comparatively higher cost. The statement was contested by Professor Knight[2] and there followed some further discussion[3], comment upon which was given by Haberler[4] and Viner[5] in their well-known books on the theory of international trade[6]. In the

[1] Frank D. Graham, "Some Aspects of Protection Further Considered", Qu. J. Ec. XXXVII (1922/3), p. 199.

[2] F. H. Knight, "Some Fallacies in the Interpretation of Social Cost", Qu. J. of Ec. XXXVIII (1923/4), p. 582.

[3] Frank D. Graham, "Some Fallacies in the Interpretation of Social Cost, A Reply", Qu. J. of Ec. XXXIX (1924/25), p. 324; Frank H. Knight, "On Decreasing Cost and Comparative Cost. A Rejoinder", Qu. J. of Ec. XXXIX (1924/5) p. 331.

[4] Gottfried Haberler, Der Internationale Handel, Berlin 1933, p. 149-156.

[5] Jacob Viner, Studies in the theory of International Trade, New-York—Londen 1937, p. 475-482.

[6] I have not found any comment on this discussion in: Bertil Ohlin, Interregional and International Trade, Cambridge, Mass. 1933 and R. F. Harrod, International Economics, London—Cambridge 1933.

discussion two points may be distinguished. First the question arises whether the case of decreasing marginal cost has much importance in practice. Most authors contesting Professor Graham's thesis hold that this is not so; the present author finds himself much in sympathy with this standpoint. Nevertheless the possibility of decreasing costs cannot quite be denied. The second point to be considered is, then, whether or not, and if so, under what further conditions, Professor Graham's statement is correct. In the present author's opinion, the main points in this question have, however, not or not very clearly, been met in the discussion and the comments. This appendix is an attempt to state the problems involved in a more exact way, with the help of analytical and graphical methods. After an exposition (§§ 1 - 8)[1] of the method and the author's own conclusions, a critical examination of the whole discussion is given (§ 9).

1. Measuring the 'advantage' to a country of international trade.

Strictly speaking it is not possible to tell whether or not a given country has an 'advantage' from the existence of international trade, since it is, on closer examination, not possible to give a precise meaning to the notion of 'advantage' to a country. It is possible to speak of an advantage to a single person; a given change in his situation brings him either to a higher or to a lower level of satisfaction (ophelimity). Since this satisfaction cannot be measured

[1] It may be observed that in the language of theoretical economics the case to be treated in these sections is that of isolated exchange between two individuals each producing two commodities. The individuals are, however, assumed to behave as in competitive markets.

and, a fortiori, a common measure for the satisfaction of the various subjects constituting a country does not exist, it is, however, impossible to add up the advantages or disadvantages for the single persons and hence also to give a precise meaning to the notion of advantage to a country. As, on the other hand, the discussion on the 'advantages of international trade' only has sense if some convention on this notion is accepted, we shall, in what follows, proceed as if a country as a whole also possesses a system of 'indifference curves', similar to those for a single person. We speak of 'curves' only and not of surfaces, etc., since we shall only discuss cases in which we have to do with two commodities 1 and 2, the consumed quantities of which, x_1' and x_2', determine the 'satisfaction' of the country $\Omega\ (x_1', x_2')$. Each indifference curve $\Omega\ (x_1', x_2') = C$ is constituted of (is the locus of) all commodity combinations x_1', x_2', that yield an equal satisfaction to a country. A combination x_1'', x_2'' yielding a higher satisfaction than a combination is situated on a 'higher indifference curve' etc. We make the usual assumption that these curves turn their convex side to the origin.

2. The possibility of decreasing and increasing marginal cost.

For simplicity's sake we assume that there is only one productive agent, which we call labour. The total quantity of labour a is given and is fully employed. The quantities used in the production of commodities 1 and 2 are denoted bij a_1 and a_2; hence

$$a_1 + a_2 = a \qquad (1)$$

The quantity a_1 depends on the quantity x_1 of commodity 1 it is desired to produce; likewise a_2 depends on x_2:

$$a_1 = \varphi_1 (x_1) \tag{2}$$
$$a_2 = \varphi_2 (x_2) \tag{3}$$

The functions φ_1 and φ_2 are called *costfunctions.* Marginal cost in each case is $\varphi_1' (x_1)$ and $\varphi_2' (x_2)$, respectively; these expressions always have positive values. They may, however, be increasing or decreasing functions of x_1 and x_2. The case of *increasing marginal cost* is the normal case. *Decreasing marginal cost* for a whole branch of industry will hardly occur. Even if for a single enterprise the 'law of decreasing marginal cost' is assumed to prevail, it need not be valid for the industry as a whole. The law will, as a rule, only exist for certain intervals of the quantity produced in a single enterprise. It is a well-known fact that no situation of competitive equilibrium is possible within such an interval. If the branch is constituted of more than one enterprise, an extension of production will usually mean the necessity of using less productive units, i.e. increasing marginal cost. Only if the most economic size of the unit exceeds the size of the branch as a whole, will there be one enterprise; then, too, competitive equilibrium within the interval of decreasing marginal cost is not possible.

3. A GRAPHICAL REPRESENTATION OF THE EQUILIBRIUM OF PRODUCTION AND INTERNATIONAL TRADE.

In fig. 1 let x_1 and x_1' be measured along the positive part of the horizontal axis and x_2 and x_2' along the positive part of the vertical axis. The negative halves of these axes are used for plotting a_1 and a_2, respectively. In the fourth quadrant we draw the cost curve $a_1 = \varphi_1 (x_1)$, assumed to be of the normal (convex) type. In the second quadrant the curve $a_2 = \varphi_2 (x_2)$ is drawn in a similar way; to begin with,

it is also assumed to be convex. In the third quadrant the line $a_1 + a_2 = a$ is indicated, being the locus of all possible applications of productive resources. From these data the '*production curve*' may be deduced, indicating all combinations x_1, x_2 that the country is able to produce. This curve has the equation:

$$\varphi_1 (x_1) + \varphi_2 (x_2) = a \tag{4}$$

Any point Q of this curve is obtained from the corresponding point Q' of the line (1) by the dotted lines in fig. 1. In the absence of international trade quantities produced x_1 and x_2 coincide with quantities consumed x_1' and x_2'. For its consumption the country therefore has to choose between the points on the production curve only. It will attain a maximum satisfaction if it chooses point A where the production curve is tangent to one of the ophelimity curves, plotted against the $x_1 - x_2$ - axes: there is no point with a higher satisfaction to be found on the production curve. Under free competition this point will be attained automatically. The price relation between goods 1 and 2 will be indicated by the absolute value of the slope of the common tangent line to the two curves in P; i.e. that slope indicates the ratio between the quantity of x_2 exchanged for a unit of x_1; i.e. the price of x_1 in terms of x_2.

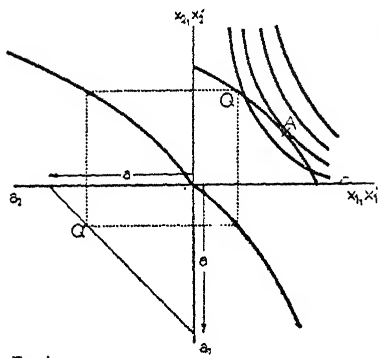

Fig 1

Now assume that an opportunity is opened to buy or sell in an international market at a given price p of x_1 in

terms of x_2, represented graphically by the slope of the line $R\,S$ in fig. 2, where the first quadrant of fig. 1 has been reproduced. This means, first, that no longer x_1 has to coincide with x_1' and x_2 with x_2'.

A 'consumption point' $x_1'\,x_2'$ may now be reached, different from the 'production point' $x_1\,x_2$ and connected with the latter by the equation

$$x_1' = x_1 + p\,(x_2 - x_2'),$$

indicating that the consumption of good 1 equals its production x_1, plus the quantity bought in the international market, at a price p, for a quantity $x_2 - x_2'$ of good 2; the consumption of 2 now being less than x_2. Of course also x_2' may be $> x_2$, but then x_1' will be $< x_1$.

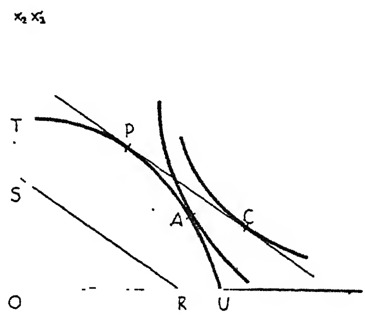

Fig. 2

Fig. 2 easily discloses what the new equilibrium situation will be. With the given price relation p producers will find it advantageous to use their productive resources in another way than before: in the case assumed in fig. 2, where p is lower than the price relation prevailing at point A, it will pay them to produce more of good 2 and less of good 1; equilibrium will be attained only if the marginal products obtained are of equal value. This means that they will proceed to point P, where the tangent line to the production curve is parallel to the given line $R\,S$. Having produced the quantities x_1, x_2, corresponding with P, the country is now free to exchange part of its production at the terms

expressed in equation (5), i.e., in graphical language, it is free to move along the 'price line' $P\,C$. This it will do until it has reached the point of maximum satisfaction, being point C, where $P\,C$ is tangent to an indifference curve. The new equilibrium is therefore represented by the two points P, C, the '*production*' and the '*consumption point*', respectively.

Under conditions later to be enumerated, *the satisfaction obtained in the new situation will always be greater than that obtained in the old one.* For, $P\,C$, as a tangent to a convex curve, will, for any value of x_1, show a higher value of x_2 than the corresponding point of the production curve[1]. Since the equilibrium point in the absence of international trade, A, is necessarily a point of the production curve, the satisfaction in C always exceeds that in A, except in the particular case where A and C coincide, i.e. where the price relation p in the world market equals the price relation existing without international trade. Hence, under the conditions to be discussed, *the introduction of international trade always means an advantage* to a country; with the exception of such 'boundary cases' where the advantage is zero.

4. Non-tangent price line.

This important conclusion was reached on a number of conditions, the influence of which we will investigate in the following sections. The conditions are:

[1] From P to the left, $\frac{dx_2}{dx_1}$ for the production curve is, in absolute measure, always smaller than $\left|\frac{dx_2}{dx_1}\right|$ for the price line; from P to the right $\left|\frac{dx_2}{dx_1}\right|$ for the production curve is always larger than $\left|\frac{dx_2}{dx_1}\right|$ for the price line.

(i) the production curve is convex;
(ii) prices are equal to marginal costs;
(iii) there exists a point P on the production curve for which the slope of the tangent equals the price relation p in the world market.

We shall first remove the last condition. It is conceivable, in fact, that the price prevailing in the world market is lower or higher than the absolute value of the slope of any tangent to the production curve; in the case of a convex curve this only means that it is lower than that slope for T or higher than that for U, the two terminal points of the production curve. In those cases the production point will coincide with T or U respectively; the conclusions drawn remain valid, however, as is easily read from the diagram.

5. Concave production curve.

Next we remove the first condition mentioned in section 4. This condition is closely connected with the nature of the cost curves assumed. If both cost curves are of the increasing marginal cost type, the production curve is convex. It may be convex too, however, if one of the cost curves is of another type. This depends on the degree in which the curve deviates from the normal type. We shall go into this question in section 6 below. Now we start from the other end and we assume that both cost curves are increasing marginal cost curves. Graphically, this means that both these curves are themselves concave and it easily follows that also the production curve is concave (fig. 3). Now all points on the production curve, except the terminal points, are *unstable equilibria.* Extension of the production of one of the goods at the expense of the other always

means an increase in total value of production: the expanding industry gets more productive and the declining industry less productive than at the initial point.

If the opportunity of international trading is opened at a price ratio corresponding to the slope of a line $T\,V$, point T will be the more advantageous point and similar to what we discussed above (section 3) a consumption point C will be chosen. Generally point T will, in the presence of trading opportunities, be the production point if the price of 1 in terms of 2 is lower than the figure corresponding with the line $T\ U$, whereas U will be the production point if that price is higher than that figure. As an example of this latter situation, the price line $U\,C'$ is drawn, with a consumption point C'.

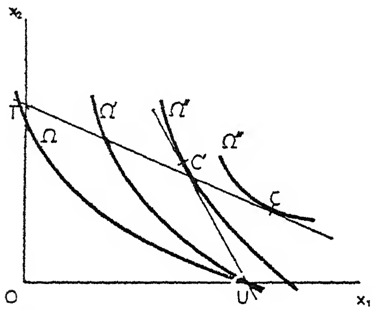

Fig 3

Again the conclusion can be drawn that the *introduction of international trade increases the satisfaction to be obtained for the country*, with the exception of possible (but not necessarily existing) boundary cases. One boundary case is the one where the price line through U coincides with the tangent to the ophelimity curve through that point.

6. A STRAIGHT LINE AS PRODUCTION CURVE; MIXED CASES.

As a special case, often made use of in simple expositions of the theory of international trade, we now consider the case where the cost curves are straight lines, the case of *constant*

marginal costs. The production curve is now a straight line too, of which each point is a point of indifferent equilibrium. Apart from this difference with the preceding case the same conclusions are valid. More complications arise if one of the industries operates under increasing and the other under decreasing marginal costs. It then depends on the exact form of the two cost curves, whether the production curve is convex, concave or of a more complicated type. If one cost curve is 'highly' convex and the other only 'slightly' concave, the production curve will be convex, etc. There may be intervals where convexity and others where concavity prevails[1].

In order to suggest that also in these cases of a 'mixed' production curve our statement about the advantage of international trade holds as a rule, we consider an arbitrary case of this class (cf. fig. 4).

For prices lower than the slope of TU a stable production equilibrium will be found between U and S. The consumption point will be either at the exterior of the production curve or, in boundary cases, on that curve.

[1] A more exact study must be based on the analytical expression for these properties. An interval of a curve $y = f(x)$ is convex if $\frac{d^2y}{dx^2} < 0$ throughout that interval. In the notations used above we have:

$$\frac{d^2x_2}{dx_1^2} = \frac{\frac{d^2\varphi_2}{da_2^2} + \frac{d\varphi_1}{da_1^2} \cdot \frac{d\varphi_2}{da_2} \Big/ \frac{d\varphi_1}{da_1}}{\left(\frac{d\varphi_1}{da_1}\right)^2} = \frac{\varphi_2'' + \varphi_1'' \frac{\varphi_2'}{\varphi_1'}}{\varphi_1'^2} \qquad (6)$$

Since φ_2' and φ_1' are always positive, we see that $\frac{d^2x_2}{dx_1^2}$ is a weighted sum of φ_2'' and φ_1''; the weights varying along the curve. If φ_2'' and φ_1'' are of equal sign, $\frac{d^2x_2}{dx_1^2}$ has the same sign; if they are, however, of opposite sign, many possibilities exist.

Therefore, the satisfaction will be at least as great as before the existence of international trade.

For prices higher than corresponds to the slope of $T\,U$, point T will be one possible production point. The corresponding consumption point will lie on $T\,U$ and hence — apart from boundary cases — show a higher satisfaction level than in the absence of international trade.

This is not, however, the whole story. For some prices in this interval there are two equilibrium points. With a price only slightly higher than that corresponding with $T\,U$ there is a possible equilibrium point in the neighbourhood of U, since the production curve is convex also for some interval below U. The existence of two equilibrium points is nothing new: it was discussed in some detail by Koopmans[1]. It implies that, if by trial and error over small distances of the production curve, one of these equilibrium points is found and persists, the possibility exists that this point is not the absolute optimum but only a relative one. If we assume complete knowledge of all data with the economic subjects, they finally will choose the absolute optimum.

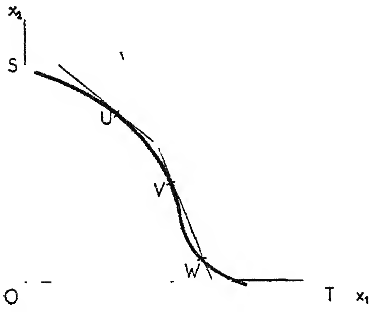

Fig 4

If that knowledge is not supposed to exist, they may stay at the lower, relative, maximum. In that latter case it may

[1] J. G. Koopmans, „De mogelijkheid van meervoudig economisch evenwicht", De Economist *81* (1932), p. 679, 766 and 841 and „Marginale kosten, marginale opbrengsten en optimale productie-omvang" in: Economische opstellen aangeboden aan Prof. Mr F. de Vries, Haarlem 1944, p. 149.

happen that the consumption point is one of lower satisfaction than the one prevailing before international trade was introduced. This case occurs if the course of the ophelimity curves happens to be such that the tangent point lies below W (cf. fig. 4). It then lies in the interior of the production curve.

Hence, *one condition has to be maintained in these mixed cases: the one of perfect market knowledge.*

7. Calculation of prices on the basis of average instead of marginal cost.

Finally we have to investigate the consequence of a removal of condition (ii) (section 4). This will appear to be a more serious threat to the validity of our statement. The necessity of assuming that prices are not equal to marginal costs of production only exists in the case of a decreasing marginal cost function. In industries where this law is valid, the equality of prices and marginal cost would entail a permanent loss to the producers. Hence it is probable that, in the long run, prices will be higher and in fact equal to average cost. In order to study the consequences of this hypothesis let us assume that industry 1 operates at decreasing marginal

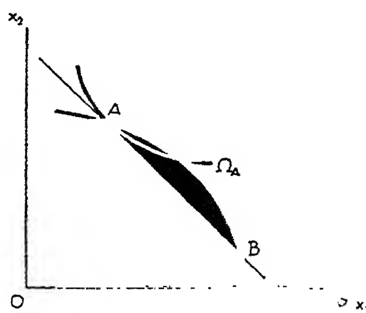

Fig 5

cost and that production is adjusted to its price in such a way as to make average cost equal to price. Since average costs are higher than marginal cost, this means that the

(absolute value of the) slope of the price line is now, in the equilibrium point, higher than the slope of the tangent.

Let us further assume that the production curve is still convex. In the equilibrium point without international trade a point A will now be chosen where there is no longer identity of tangents to the production curve and the ophelimity curve. The price line AB now intersects the production curve, since its slope must be higher than that of the tangent. It is still a tangent to the ophelimity curve. This already means that the point of maximum satisfaction on the production line is not chosen: this way of calculating prices is disadvantageous to the country.

Now consider the case with international trade (fig. 6). Let PQ be the price line and P the corresponding production point. There are two possibilities now, indicated in fig. 6 by the subscripts 1 and 2 and by full and dotted ophelimity curves respectively. In the first case, where the ophelimity curve through A, Ω_{A1}, does not intersect with PQ, the consumption point C_1 shows indeed a lower degree of satisfaction than A. Here *international trade is a disadvantage to the country*. In the second case, where the ophelimity curve through A, Ω_{A2}, does intersect with PQ, the satisfaction in C_2 is again higher than that in A and our former statement remains valid. Since both possibilities must be recognised, it follows that the removal of condition (ii) (section 4) is vital to our statement. Hence our general

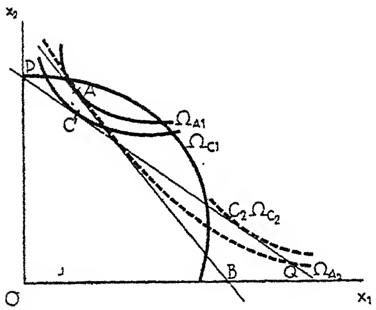

Fig 6

conclusions may be formulated: *in the simple case considered (two commodities and one agent of production) international trade is an advantage (or as a boundary case no disadvantage) to every country involved, provided that:*

1. *there is perfect knowledge of market data and*
2. *prices are calculated on the basis of marginal cost.*

8. A DIAGRAM FOR TWO COUNTRIES.

So far we only considered the position of one country finding itself vis-à-vis a world market with a *given price relation p* for good 1 in terms of good 2. We shall now try to answer the question *how that relation* itself is determined in the simplified case where there is only one other country in that 'world' market. It is by a simple extension of our graphical method that the answer may be given.

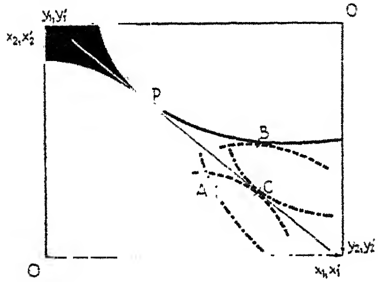

Fig 7

In fig. 7, relating, as far as our first country, 'country A', is concerned, to the same situation as fig. 2, the co-ordinates x_1, x_2, x'_1 and x'_2 are, as before, plotted from the origin O, but in the opposite direction. The corresponding co-ordinates for country B, denoted by y_1, y_2, y'_1 and y'_2, are plotted from O'. The point O' is simply chosen in such a way that its co-ordinates with respect to O are x_1+y_1 and x_2+y_2, respectively, or, which is the same, $x'_1+y'_2$ and $x'_2+y'_2$. This implies that A's and B's production points coincide (point P) and their consumption points as well (C). A's ophelimity

curves are indicated by —.—.—, whereas B's are indicated by — — — — curves. The points A and B are the production (and consumption) points of countries A and B respectively, in the absence of international trade. The essence of the graphical representation is that $P\ C$ is at the same time tangent to both production curves in P and to an ophelimity curve of each country in C. For the case represented, the one of convex production curves and point P for neither country in a 'boundary situation', the advantage of international trade to both countries is clear: the satisfaction to A is greater in C than in A and the satisfaction to B is greater in C than in B. The diagram cannot be constructed unless the position of C is given and this depends on the unknowns of the problem, viz. x_1. x_2, y_1 and y_2. Hence it might seem that the diagram is of no help in finding p. As a matter of fact, all these unknowns must be determined simultaneously; i.e. one must so long 'play round' with O' until a position is found where there exists — which is not generally the case — a common double tangent line to the system of ophelimity curves and the two production curves.

There are a great number of different cases as to the shape of the production curves and the situation of the production and consumption points; quite a number of boundary cases being among them. It may be left to the reader to go into these questions.

9. Conclusions.

We now propose, in the light of the foregoing analysis, to examine professor Graham's statement and the comments made upon it.

It seems that professor Graham gave his final standpoint

at the end of his second article. There it is assumed that in the world market (represented, in his example, by England) one unit of wheat is interchangeable for one watch. It is not stated how much wheat and how many watches are produced in the absence of international trade (our point *A*); so we may draw this point arbitrarily in fig. 8, relating to professor Graham's example[1]. The point reached after international trade has been introduced, our point *P*, corresponds to a production of 73,700 more units of wheat and 73,000 watches less than before. Professor Graham seems to assume further that the 73,700 units of wheat that are produced in excess of the original production are exchanged for an equal number of watches.

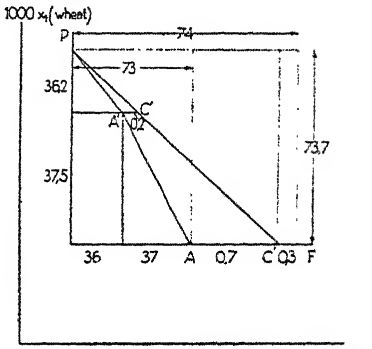

Fig 8

Thus point *C* is reached (fig. 8). How now does he argue that the position in this point *C* is less advantageous to the country? 'The result of the whole trade — he says — is thus to secure 73,700 watches for the same effort as was originally producing 74,000 watches — a loss of 300 watches, to say nothing of the diminished returns to effort prevailing in the whole of the remaining American watch industry if that industry continues to struggle on'. This 'same effort'

[1] The true proportions of this diagram do not cover the figures; they have been chosen such as to show more clearly the convexity of the broken line PA'A and the relative position of the points A, C and F.

he is alluding to, relates to the productive agents producing the additional wheat; those agents were formerly engaged in watch making. The figure of 74,000 watches they were 'originally producing' is calculated on the basis of the *average* productivity of the watch industry then prevailing; not on the marginal productivity. In this way professor Graham introduces a fictitious point F to which he compares the point C reached after trade has been introduced; and then C appears to be less advantageous to the country than F. The real point of departure is, however, point A, and comparison should be made between A and C; it is at once clear that C is more advantageous to the country than A. The fictitious character of point F lies in the circumstance that the decrease in watches produced between F and P is calculated on the basis of the *average* productivity of watch making, whereas the increase in wheat production is computed on the basis of the *marginal* productivity of wheat growing.

This point seems to have been overlooked by Professor Knight as well as the other commentators. Knight does not go into the figures at all, although they were changed by Graham in order to meet his criticism. Haberler[1], after having literally cited Graham's conclusions, adds that one must concede that this deduction is right. Viner[2], when reproducing Graham's argument, changes the figures; apart from that change it is not clear whether the figures he assumes as the yield of one day's labour are meant as average or as marginal productivities. From the fact that he bases price ratios upon them, one would deduce that he means marginal productivities; from the fact however, that he calculates total productions by multiplying his 1 day

[1] Loc. cit. p. 150/151.
[2] Loc. cit. p. 476/477.

figures by the number of days worked, it would follow that he means average productivities. If the latter be accepted for a moment, his figures show an implicit contradiction, since he assumes that the total product of 399 days of wheat growing is less than the total product of 200 and 300 days. In other words, his example does not fulfil the condition that total costs of production cannot be a falling function of the quantity produced.

Of course, Viner himself is conscious of some of the ambiguities involved, but he fails to restate things in unambiguous figures. In another context, however, he rightly observes: 'Had Graham dealt with his problem in terms of marginal costs and marginal returns for both industries, he could not have obtained results unfavorable to free trade.' This indeed, as we have seen in the above analysis, is the crucial point, provided however, that, in 'mixed cases' (cf. section 6) perfect knowledge of market data is assumed for all subjects. It is to be doubted, however, whether the average reader of Knight's as well as Haberler's and Viner's exposition will retain this point as his chief impression; in particular that he will be aware of the fact that Graham may be right in the case of price calculation on the basis of average cost.

Appendix II

MORE EXACT VALUATION OF THE MAXIMUM AMOUNTS OF UNILATERAL PAYMENTS THAT CAN BE TRANSFERRED

A first objection to the computation given in the text, as first made by Keynes in these discussions[1], is that the changes in imports have not been taken into account which occur in consequence of changes in price level, necessary to stimulate exportation. The simplest way to take these into account is by a mathematical-economic treatment. The following is an instance of this.

We indicate the volume of exports by u^e, the volume of imports by u^i and home production by u. The national price level be p, the foreign price level, measured in the currency of the country under consideration (whose rate of exchange is assumed as constant) p^w. We assume that the prices of exported articles are proportionate to the national price level, those of imported articles to the foreign price level. The value of exports U^e is then equal to $u^e p$, that of imports $U^i = u^i p^w$. We start from a situation in which there is equilibrium between import and export value, where consequently $U^e = U^i$. If a unilateral payment T ('tribute') is to be made now, U^e and U^i must change with amounts dU^e and dU^i, which are such that

$$dU^e = dU^i + T. \tag{1}$$

Like Keynes, we assume that this change is obtained by a general price reduction of national products; the change in prices be dp; p^w will remain unchanged then.

[1] The German Transfer Problem, The Economic Journal, XXXIX (1929), p.1.

In consequence of this price reduction the volume of exports will increase; we put: $du^e = -\varepsilon^e u^e dp$, (2)
in which ε^e may then be called the elasticity of demand for exports.

Owing to the change in prices also the total production u will change; we put: $du = +\varepsilon u dp$, (3)
in which ε is the elasticity of supply of total production.

Imports will change likewise; they depend upon the price level at home (if this is low, imports are less remunerative than when it is high, taking it that all other determinants are the same) as well as upon the level of production. We put: $du^i = \pi du + \varepsilon^i u^i dp$, (4)
in which π is the import-quota of production and ε^i the elasticity of demand for imports.

Finally it follows from the definitions of U^i and U^e that:

$$dU^i = p^w du^i \tag{5}$$

$$dU^e = pdu^e + u^e dp + du^e dp \tag{6}$$

We now consider dp as the unknown, the value of which is to be ascertained in dependency on the amount to be transferred T. The above equations enable us to do this. As we have the choice of the unit of quantity of goods still in our hands, we do it thus that the two price levels p and p^w are indicated in the original situation by the figure 1 (in other words: we express both price levels in index-numbers with the original situation as starting-point). Thus we get from (1), (5) and (6):

$$du^e + u^e dp + du^e dp = du^i + T \tag{7}$$

We now substitute (2), (3) and (4); we then get:

$$-\varepsilon^e u^e dp + u^e dp - \varepsilon^e u^e dp^2 = \pi\varepsilon u dp + \varepsilon^i u^i dp + T \tag{8}$$

As $\pi = \dfrac{u^i}{u}$ and $u^i = \dfrac{U^i}{p^w} = U^i = U^e = \dfrac{U^e}{p} = u^e$,

we can also write for (8):

$$dp(1 - \varepsilon^e - \varepsilon^i - \varepsilon) - \varepsilon^e dp^2 = \frac{T}{u^e} \tag{9}$$

This is a quadratic equation for dp; for every value of T it yields two values for dp; but only in case T does not exceed a certain maximum T_M. This maximum can be found by putting the discriminant of the quadratic equation at nought; the result is:

$$T_M = \frac{u^e}{4\varepsilon^e}\,(1 - \varepsilon^e - \varepsilon^i - \varepsilon)^2 \tag{10}$$

and herewith the maximum transferable amount has been found. This result passes over into Keynes' by putting

$$\varepsilon^i = \varepsilon = 0.$$

In order to be able to make a numerical calculation of $\frac{T_M}{u^e}$, i.e. the relation between the maximum amount and exports (for which we may take the value of exports, as $u^e = U^e$ in our units), we must know the three elasticities occurring in formula (10). As already stated in the text, we may put it that ε^e approximately $= 2$. Statistical determinations of ε^i have yielded lower values for this coefficient. We presume that values of ½ and 1 are possible here. With regard to ε it should be observed that its value largely depends upon the degree of employment of the productive apparatus. If full employment is approached, then $\varepsilon = 0$, while with severe under-employment very high values may occur. From formula (10) it can be seen that, once $\varepsilon^e + \varepsilon^i + \varepsilon > 1$, each further rise of ε leads to a strong rise of T. In this is reflected the circumstance that in case of a strong reduction of prices, exports increase, it is true, but home production and imports decline. Owing to this also home consumption declines, and soon a point would be reached that, from

considerations of transfer, would allow of large payments, but would appear to be untenable from internal social considerations or even technically impossible. These are situations, where the transfer problem no longer forms the principal obstacle.

We believe we put our problem correctly if we attach the condition to it that there is a situation of full employment; then $\varepsilon = 0$. (A more complicated formulation in which attention is paid to wage changes as the primary factor and corresponding price changes, is to be preferred. It would lead us too far, however, to enter further into this question here).

In the following table the values for T and for dp have been brought together which correspond with $\varepsilon^i = \frac{1}{2}$ and 1, while we have taken $\varepsilon^e = 2$ and $\varepsilon = 0$.

ε^i	T_M	dp
$\frac{1}{2}$	$0.28\ U^e$	-0.38
1	$\frac{1}{2}\ U^e$	-0.50

From this it will be seen that already with $\varepsilon^i = \frac{1}{2}$ a very strong decline in prices would be necessary to attain the maximum calculated; from which it becomes probable that for technical reasons this maximum cannot be realized. The same thing holds good a fortiori in case it is taken that $\varepsilon^i = 1$ or $\varepsilon > 0$. Therefore our more exact calculations corroborate the argumentation given in the text.

Not much would change in these calculations, if, on account of a criticism made by Ohlin, another objection should be taken into account that may be raised against the calculations by Keynes. This objection is that Keynes

has overlooked the fact that the payment T leads to an increased income of foreign countries, resulting in an increased demand for export products from the paying country. Thereby exports already increase a little, even without a reduction in their price. Ohlin is even of opinion that consequently a reduction of prices is not at all necessary, and thinks that accordingly the transfer problem does not exist. This conclusion is wrong, in our view. The increase in the demand which arises in consequence of the increase of income T is only a small fraction of T, if there comes no change in the price relation between home and abroad. For a rise of income is spent first and foremost on home-made products and only for a small part on products of other countries, among which the paying country under consideration is only one. The fraction of T which is spent on products of the paying country will approximately equal the relation between its exports U^e and the total income of the foreign countries Y^w and this relation is a figure far below 1. Therefore our results will change only very little, if we do take Ohlin's criticism into account.

Appendix III

SOME NON-ECONOMIC CONSIDERATIONS WITH REGARD TO ANNEXATION BY THE NETHERLANDS OF GERMAN TERRITORY (CF. CHAPTER VII)

As was observed already in chapter VII, some proposals have been launched in the current year inside and outside our country concerning an enlargement of Dutch territory at the expense of Germany. In chapter VII we only discussed briefly some economic aspects of these changes of territory, faithful to the plan of this work. It is our opinion, however, that far wider than only economic considerations must turn the balance in judging these proposals; considerations which we can only describe as 'generally political': besides economic elements they contain elements regarding the technique of administration, military, social-pedagogic, historical and other elements, all of which are beyond the domain of the present writer. Hence the best solution can only be found by a cooperation of a large number of experts. The considerations to which we refer have, moreover, a far wider tendency than the argumentation on which the Dutch proposals mentioned above, are mostly based. The issue is not in the first place a question of reparations to the Netherlands for inflicted damage, but questions of the future stability of the whole of European life; perhaps even the saving of our civilization. A wrong solution of the problem how to deal with German territory and the German population conceals perils whose significance rises far above that of reparations; a correct solution can bring benefits which are of far greater importance.

The stability of European life and the survival of our civilization have been seriously threatened by the inhuman mentality of national-socialism, particularly towards the Jews, but also towards the opponents of their own race and in general with regard to the relation between man and the state, and between one state and the other. It is true that some of the national-socialistic notions are to be considered as a continuation of or a reaction to methods, applied and propagated by the Russian communists, but national-socialism is not exculpated by that: by these facts the responsibility of communism is charged as well.

The fundamental question to be considered after the war is: can the German nation as a whole be made responsible for the barbarities of national-socialism, or can only the bearers of that regime be considered responsible? No doubt the Germans are partly as much the victims of a series of coups d'état as we other nations of the continent of Europe. While they could still utter themselves freely, they were in a considerable majority against national-socialism. In order to ascertain the responsibilities, a thorough sociological investigation, under the guidance of first class experts, must be made, an investigation into the way in which the changes in Germany have been brought about, the importance for these of all kinds of institutions in that country and into the possibilities to prevent a similar procedure in future. In connection with this the essential question must be looked into, whether the German nation, under better leaders and with a better organization, is prepared and able to cooperate in a humanistic and stable Europe.

This problem cannot and must not be judged by politicians only. The development of sociology has got far enough to make us realize that only experts trained in these

matters can give well-founded advice. It is particularly in the United States, but also in Germany itself, that these experts are to be found. The investigation meant above should take place before a final peace-treaty is drawn up.

A priori widely different results of this investigation can be imagined. Both the view of old Clemenceau that the Germans are incorrigible and unable to live in a stable and humanistic Europe, and the opposite view that the majority of the Germans were themselves victims of their nazi regime, can be imagined as the result. The measures that will be needed are widely different in proportion as the one or the other result is obtained. If Germany should prove to be willing and able to cooperate, no unnecessarily harsh measures should be taken against a new Germany; then — after a period of transition, in which they can show their good intentions — it is even possible that a strong Germany is in the interest of Europe. Should it be unwilling or incapable of such cooperation, however, quite different measures may be necessary.

If cooperation is possible, a whole complex of measures is imaginable to make it stronger. This complex comprises economic as well as non-economic measures. It will, for instance, be useful to prevent wide-spread unemployment; sensible work will have to be found for ex-service men. Care will have to be taken that no new foci of infection spring up, such as certain unions of extremistic young men. On the other hand we should guard against awakening any kind of sickly nationalism. A division of German territory, however, might exactly further the growth of a nationalistic sentiment. If, therefore, the willingness in Germany to cooperate in a new Europe is strong enough, it is possible that such a division would exactly act in the wrong way.

But is may also be otherwise; if Clemenceau should be right after all, a division may have a beneficial effect.

What is essential, however, is that it is not the question whether the Netherlands require certain damages that is of paramount importance, but, as we said before, the much more important question how Europe is to be stabilized for the future. Also for Holland this latter question is of much greater importance. It is greatly to be hoped that those who, in this and other countries, will have to decide in these matters, will be well aware of this. We now need an internationally justified plan, well thought out in every respect, and no dilettantism prompted by temporary national interests.